

104 THE INTERNAL REVENUE SERVICE'S INITIATIVES  
TO REDUCE REGULATORY AND PAPERWORK  
BURDENS ON SMALL BUSINESS

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Y 4. SM 1:104-56

The Internal Revenue Service's Init...

HEARING  
BEFORE THE  
COMMITTEE ON SMALL BUSINESS  
HOUSE OF REPRESENTATIVES  
ONE HUNDRED FOURTH CONGRESS  
FIRST SESSION

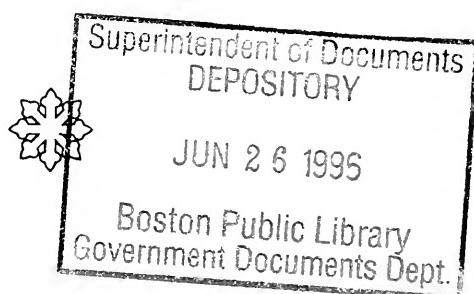
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WASHINGTON, DC, OCTOBER 25, 1995

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Printed for the use of the Committee on Small Business

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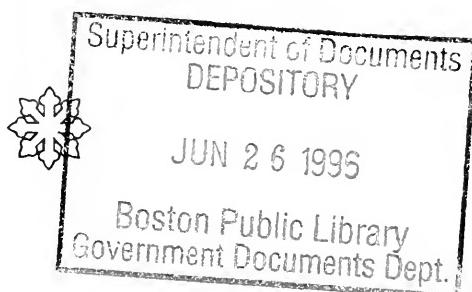
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# **THE INTERNAL REVENUE SERVICE'S INITIATIVES TO REDUCE REGULATORY AND PAPERWORK BURDENS ON SMALL BUSINESS**

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**WEDNESDAY, OCTOBER 25, 1995**

**HOUSE OF REPRESENTATIVES,  
COMMITTEE ON SMALL BUSINESS,  
*Washington, DC.***

The committee met, pursuant to notice, at 10:07 a.m., in room 2359, Rayburn House Office Building, the Honorable Jan Meyers, (chair of the committee), presiding.

Chairwoman MEYERS. Good morning. I'm sorry I'm a few minutes late, and I think we will have some other members here shortly, but there are lots of other meetings going on this morning.

Today the Small Business Committee will hold a hearing on the Internal Revenue Service's initiatives to reduce regulatory and paperwork burdens on small business.

The IRS itself estimates that the American public expends over 5 billion hours in responding to the regulatory forms, reports, and recordkeeping requirements of the tax system. At \$50 an hour, that amounts to over \$250 billion of effort on the paperwork demands alone. Small business carries a disproportionate share of that burden.

In May, the President signed the Paperwork Reduction Act of 1995, legislation that passed this Congress unanimously and established a goal of reducing the Government's overall paperwork burden upon the public by 10 percent in each of the upcoming 2 years.

When you consider that the IRS share of that goal will be some 500 hours or \$25 billion, you get a picture of the enormity of today's subject matter.

I want to welcome Margaret Richardson, the Commissioner of the IRS, who will provide us a progress report on the IRS's efforts on this issue and participate in this morning's panel with four leading voices from the small business community.

Commissioner Richardson made a lasting impression at the White House Conference on Small Business this past June when she put on a hard hat in addressing conference delegates. We are glad you survived that experience, Mrs. Richardson, and I want to thank you for your continuing willingness to sit down with the small business community and members of this Committee to discuss efforts to reduce regulatory and paperwork burdens.

I also want to welcome our distinguished panel of small business witnesses. Jack Faris is a small businessman, as well as the presi-

dent of the National Federation of Independent Business. Ken Wolfe, who will be introduced by Jeff Joseph, vice president for domestic policy of the U.S. Chamber, is a small businessman who hails from Kentucky and was a delegate to the White House Conference.

Bill Fisher is the executive vice president of the National Restaurant Association. Bennie Thayer—except he's not here yet—is the president of the National Association of Self-Employed and also headed the Maryland delegation to the White House Conference.

Mr. GOLDSTEIN. Madam Chair, Mr. Thayer should be here shortly but I will fill in until he does come.

Chairwoman MEYERS. All right. Very good. Thank you for being here.

At the White House Conference, the President committed his administration to reducing significantly regulatory and paperwork burdens on small business. He highlighted his March 4, 1995 memorandum to department and agency heads on regulatory reinvention initiatives, and that's why we're all here this morning.

He directed that they make regulatory reform a priority, do a page by page review of all regulations, and report to him on which regulations would be eliminated, which needed congressional attention, and which they planned to reinvent.

In July this Committee began a series of oversight hearings to evaluate and develop a report card on these as well as other congressional and administrative initiatives to reduce regulatory and paperwork burdens on small business. In other words, we want to just kind of have oversight hearings as we go along.

We have heard from Sally Katzen, the administrator of the White House Office of Information and Regulatory Affairs, and Joe Dear, the assistant secretary of the Occupational Safety and Health Administration, and they participated in panels very much like this one with small business representatives. Today is our third such hearing. We plan to invite the administrator of the Environmental Protection Agency next.

Oversight is not very exciting work sometimes but, as I have stated before, I believe a major mission of this Committee is to be a forum for the small business community. Small business is the lifeblood of America. There are enormous opportunities to eliminate the unnecessary costs of regulatory compliance we should tackle if we are to encourage and enhance the entrepreneurial spirit of small business.

My intention during these hearings is to continue the dialogue between the small business community, the administration and Congress on the work of eliminating wasteful regulatory and paperwork burdens. I believe there is much common ground and common sense that can be pursued with this approach.

At this point in time I will yield to the ranking member of the committee, Mr. LaFalce.

Mr. LAFALCE. Thank you very much, Madam Chair. For purposes of brevity, why don't I simply say that I can associate myself fully with each and every one of your remarks and I ask that my opening statement be included in the record. I look forward to listening to all the panelists. Every one of whom, with the exception

of Mr. Wolfe, I believe, I've had the pleasure of working with quite frequently in the past. Thank you.

[Mr. Flake's statement may be found in the appendix.]

Chairwoman MEYERS. I see that Benson Goldstein has been re- placed with Bennie Thayer and welcome.

Mr. THAYER. Thank you.

Chairwoman MEYERS. Our first witness will be the Honorable Margaret Richardson. I think what we'll do, since she's a little out- numbered this morning, is give Ms. Richardson 10 minutes and all of our panelists five, and then we will have some dialogue. Ms. Richardson.

#### **TESTIMONY OF HON. MARGARET MILNER RICHARDSON, COMMISSIONER, INTERNAL REVENUE SERVICE**

Commissioner RICHARDSON. Thank you, Madam Chairman. I have a longer statement which I would like to have submitted for the record, if I could, and I'll attempt to summarize it.

I do want to thank you for the invitation to be here today to discuss the efforts that the Internal Revenue Service is making to make the Federal tax system fairer, simpler and more efficient for small businesses.

I understand that small businesses have concerns about the tax system that are unlike those of many individuals and larger businesses, and I welcome the opportunity today to discuss what the Internal Revenue Service is doing to address those concerns.

I also brought with me today Jim Donelson, who's our chief of taxpayer services; Barbara Jenkins, who is the director of the Office of Small Business Affairs, and Marty Washburn, who's the national director of specialty taxes.

My staff and I have devoted a considerable amount of time in the past 2 years to small business issues. We recognize that we cannot expect small business owners to comply fully with the tax laws unless they first understand their tax obligations and then have the tools they need to satisfy their obligations quickly and cost effectively.

For that reason, we've made a commitment to do what we can to assist small businesses. For starters, I established the new IRS Office of Small Business Affairs, and I introduced Barbara Jenkins, who is the director. I believed we needed a group of people in the Internal Revenue Service to be responsible for focussing on the concerns of small businesses. Barbara and her staff have been working very hard with me and many others at the IRS, trade associations, the Small Business Administration and other places in Government to improve the services that our organization provides to small businesses.

We began by listening to small business owners.

Chairwoman MEYERS. Ms. Richardson, I wonder if I could ask you to pull the microphone a little closer to your face. We can hear you fine but sometimes they can't in the back of the room.

Commissioner RICHARDSON. We participated in a forum sponsored by the Office of Management and Budget and the Small Business Administration, and at my request, we held a special series of workshops on that part of the regulatory forum that specifically focussed on IRS issues.

Our opportunities for listening expanded when President Clinton announced his regulatory reform initiative in March. He asked each head of an agency to go out of Washington and talk directly with the regulated community.

I personally have conducted seven town meetings in towns across the country, listening to the concerns of small business. When each of these meetings ended, we promised to take those concerns back to Washington and to address the ones that we could.

As you mentioned, I participated in the White House Conference on Small Business. I did not have to wear the hard hat, I might add. I was treated very courteously. I had the opportunity to participate in a 2-hour open question and answer session. What I wanted to report to you today is what we learned from listening to hundreds of small business owners and what, more importantly, we've begun to do about what we've learned.

I recognize that we haven't heard from everyone and I know there are many points of view and many different stories to tell. I also recognize that we don't have all the solutions. But I do want to assure you, Madam Chairman, that the IRS is not a large impersonal organization with neither the time nor the desire to address the concerns of small businesses.

We look forward to hearing from members of your Committee, as well as my fellow panelists here today, on what we can do to help make it easier for small business owners.

A lot of small business owners have told us that they do want to comply with their tax obligations but that we can't expect them to fully comply unless they understand those obligations and have the proper tools to satisfy them quickly and cost effectively.

Therefore, we've made a number of efforts to try to increase their understanding of tax obligations and to provide them with effective tools for satisfying those obligations.

We have a taxpayer education program on a wide variety of topics in every single IRS district. But, in response to hearing about the need for better education, we are now exploring how we can customize those workshops to specific industries and how best to use our workshop resources to provide small businesses with the kind of training they need. We've had very well received programs in New Hampshire for restaurant owners and, in Austin, Texas, for small businesses involved with international trade.

I brought with me our Small Business Education Kit, which has a number of materials that are available for small business owners on a variety of topics, like employment taxes, recordkeeping requirements and self-employed retirement plans. We distribute these kits to about 2,500 organizations nationwide, including colleges, universities and business training centers.

In response to concerns about clarity of our notices, we've begun a complete overhaul of our notices to taxpayers. Our goal is to improve the quality, the content and the format of those notices so that small business owners—in fact, all taxpayers—can understand and know how to respond to a notice without having to call us for an explanation.

The Office of Small Business Affairs is intimately involved in our notice reinvention efforts to specifically assure that the needs of small business owners are taken into account.

When I talk about regulatory reinvention or regulatory reform, I think it's important to point out that the IRS is very different from other Government regulatory agencies. Generally, we issue regulations to interpret specific tax rules that are written by Congress, and to help taxpayers better understand and meet their tax obligations.

In other words, our regulations generally do not impose new requirements or sanctions on taxpayers. Rather, they typically describe requirements and sanctions that are imposed by Congress and they attempt to give taxpayers guidance on how to comply with them.

Frankly, we're often cited for not issuing regulations quickly enough rather than for issuing too many regulations. Just last December, the GAO, in reporting on burden of Government regulations, cited the IRS's problem as not having enough regulations, not an excess.

Most small business owners tell us that the IRS regulatory process should be improved and streamlined so that more useful regulations could be issued more efficiently. The small business owners we've heard from have asked for simpler regulatory language, earlier involvement in what the regulations say, and, more importantly, an easier way to access regulatory information.

At our small business town meetings, we were asked to focus some of our efforts on our recordkeeping requirements, and we've been doing just that. I asked the task force in our national office to work with our Small Business Affairs Office to review all of our small business recordkeeping requirements. The group has come up with 35 recommendations for easing those requirements, and our next step, scheduled to begin next month, is to test those requirements with small businesses.

I think even more exciting is the fact that last month we announced perhaps the most significant change in the recordkeeping area for years. Since 1962, the threshold for which businesses were required to have a receipt for travel or entertainment expenses had been \$25. Effective October 1, we raised that threshold to \$75. We know that for small businesses in particular, the \$25 threshold had been difficult. The new threshold should make recordkeeping a lot less challenging for both businesses and employees and it's part of our on-going efforts to make Government work better and cost less.

We know that an issue of great concern to small businesses is how workers are classified; in other words, whether they're employees or whether they're independent contractors. As you know, Madam Chairman, the participants at the White House Small Business Conference identified worker classification as their number one issue of concern.

Today worker classification depends on common law standards. The courts have traditionally looked to a variety of factors and we, at the IRS, have adopted those factors in examining this issue. The problem has been that the factors are perhaps too numerous, too complex, and many of them maybe don't fit particular businesses.

What we'd like to see is a simple, uniform definition of "employee" and "independent contractor," but, of course, we can't do that ourselves under current law.

I've said in public several times recently that it really does not matter to the Internal Revenue Service whether a worker is classified as an employee or an independent contractor, as long as that worker is paying his or her proper share of taxes.

Our agents are doing the best they can to make accurate worker classification determinations under the complexity that is the common law. A straightforward definition would certainly ease our burden, as well as the burden on taxpayers. What we do know is that compliance is significantly higher when there is information reporting or withholding.

In August, Marty Washburn, whom I introduced a minute ago, testified before a subcommittee of this Committee on employment tax programs. He announced that we were developing changes to our approach to the worker classification issue in our employment tax audits, and I want to update you on the initiatives that Marty announced.

First, procedures requiring the approval of our national office here in Washington of all larger worker classification projects have been implemented, and we believe that they will ensure uniform treatment of all taxpayers.

Second, a draft of training materials for IRS examiners handling worker classification issues that emphasize the principle that using independent contractors can be a legitimate business practice that will not be challenged by the Service is going to be available in a few weeks for review and comment by the private sector including, of course, small businesses. We are working on training all of our employees, and we expect that training to be completed in January of 1996.

Now, for many years the IRS and the restaurant industry have struggled with difficult issues regarding the proper reporting of tips received by restaurant workers. I'm sure Mr. Fisher will tell you more about that. But after long negotiations and careful listening to the industry, some of which occurred during my town meetings earlier this year with small businesses, we announced in May that we had developed an agreement on reporting issues with a coalition of food industry representatives. This agreement is known as the Tip Rate Alternative Commitment, or TRAC.

Under TRAC, an employer who voluntarily agrees to the commitment must establish a reasonable procedure to report future tips, establish a program to educate all employees who receive tips, and deposit Federal employment taxes on those workers. In return, we will generally agree not to initiate an examination of the employer that might result in an assessment of tax on its employees' unreported tips for prior years. We are currently developing a training package for agreement participants, and that should be available next month also.

Small business owners have also told us they need to have the proper tools to comply with their obligations. In our efforts to improve their access to information, last December we instituted a new service on the Internet which allows people to get access to all forms and IRS publications electronically, on the Internet, through FedWorld. We also have CD ROM's on which all of our forms and publications are available. Documents can be downloaded onto a personal computer, and the forms can actually be filed that way.

We've also joined with the Department to Commerce and 14 other Government agencies to establish the U.S. Business Advisor. It's a one-stop Internet shop that directs small business owners to Government information that's available on-line, including the electronic IRS site for forms and publications I just mentioned.

We're also expanding the tax information we make available on the Internet, and next year, information on FedWorld will be broadened to include a "Dear IRS," a searchable list of frequently asked tax questions and, more importantly, answers to those questions, as well as a Tax News service that will help business, practitioners, tax software companies, and the media stay on top of the latest tax developments.

In addition, the technical tax topics that are now available on TeleFile system, which is an automated telephone assistance line, are also going to be made available on FedWorld, and several of our publications for businesses will be presented in an electronically searchable format.

Although our tax forms are frequently cited in discussions about complexity, I would like to point out that often our forms can be quite useful in helping taxpayers comply with their obligations. Our basic approach to developing forms and instructions has been to allow taxpayers to complete them without having to seek out the provisions of the law or the regulations. At the same time, we do understand the need to keep forms as simple as possible, and we're continually working to do so.

Last December, we simplified reporting of employment taxes by removing nonpayroll reporting requirements, such as back-up withholding, from the 941. That change reduced paperwork burden for an estimated 6 million employers and saved them 13 million hours in reporting time annually. In addition, the Form 1065, which is the partnership income return, was significantly revised in 1993. We changed reporting requirements for balance sheets and assets to reduce the burden for an estimated 800,000 small businesses.

As you know, Madam Chairman, the administration strongly supported the Paperwork Reduction Act of 1995, which became effective just 3 weeks ago. This new law substantially increases opportunities for the public to participate in the notice and comment period for proposed forms and paperwork requirements in proposed regulations. The law will increase the public's opportunity for comment on paperwork requirements, and we at the IRS are hopeful that it will bring a substantial increase in the number of thoughtful suggestions we receive from the public for form simplification.

While we're working hard to reduce paperwork by streamlining the content of our information requests from taxpayers, we also believe that the ultimate solution to the paperwork issue lies in finding ways to use new technology so that taxpayers can communicate with their Government as easily as they communicate with many segments of the private sector. We have recently made great strides in devising alternative, user-friendly methods of filing tax information with the IRS.

We continue to expand our programs for electronic return filing. Many small businesses are run by self-employed individuals who file a Form 1040 and they have either a Schedule C or now a Schedule C-EZ. These returns can be filed electronically, which

means a much quicker process, but probably more importantly, many fewer errors, so that the chance of any post-filing correspondence with the IRS is reduced significantly.

In October 1994 we began a pilot program to allow employers to file their payroll tax returns by electronic means. We have received and processed more than 100,000 such returns so far, and we intend to expand the program because of its success.

In January, we're going to begin to test, in the State of California, a project that will allow small businesses to meet their Federal and State employment tax filing requirements with a single electronic transmission.

We're also working to make it easier for businesses to make their tax payments. We have an electronic tax deposit system, which we call TAXLINK. It allows businesses to make their payroll and estimated tax deposits by making a phone call rather than taking a trip to the bank to deposit a check with a paper coupon. We had heard stories about some small business owners having to actually close their businesses for hours while they drove to the nearest bank to make those deposits. Hopefully, TAXLINK will eliminate this kind of counterproductive activity.

Before closing, I'd like to point out that all of our programs involving electronic and telephonic filing, paying, and assistance, many of which I've given you a brief outline of today, I think are our most promising from the perspective of giving small businesses and many other taxpayers the tools they need to meet their obligations simply and inexpensively.

But I also would like to note that these programs are only possible because of the investments we've made in the tax system's modernization. The future growth and success of these important programs, which again I think are very promising, really does depend upon our ability to continue those investments.

Madam Chairman, we are anxious to continue building on the progress we've made in the past 2 years. Unfortunately, in the current budget environment and the significant reductions that have been proposed in our 1996 appropriation, our ability to deliver the kinds of service that all taxpayers, including small businesses, deserve, could be severely curtailed.

But despite those budget constraints, I want to assure you that this agency is going to continue to do everything we can to make the tax system less taxing for individuals, for small businesses and for large businesses. We are committed to addressing the concerns of business owners and the difficulties they face.

I look forward to hearing any comments from you and your colleagues and also from my colleagues here on the panel. Thank you.

[Ms. Richardson's statement may be found in the appendix.]

Chairwoman MEYERS. Thank you very much for being with us, Ms. Richardson. We appreciate your being here, with or without your hard hat.

Our next witness will be Jack Faris, who is president of the National Federation of Independent Business. I think we're going to just delay all questions until we've heard all of our witnesses because I think it gives us a little better information to ask questions about.

So, Jack, we look forward to hearing from you.

## TESTIMONY OF JACK FARIS, PRESIDENT, NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Mr. FARIS. Thank you very much. Thank you, and NFIB and our small business community thanks you for holding these hearings and focussing on the number one problem for small business owners across America, and that's dealing with the IRS, its rules, regulations and problems.

NFIB is 53 years old. Our job is to impact public policy on behalf of the small and independent business community. We have 600,000 members, and those members average six employees per business, \$300,000 in volume, and they make about \$42,000 a year in income.

But those small businesses across the country also represent 53 percent of all working Americans. It also means that this small business community, if it were an independent nation, would be the third largest economy in the world; if you left them in the United States, to be number one.

NFIB is nonpartisan. We take stands based on issues, those issues that are told to us by our membership through a mandate process. So, what I'm speaking to you today has to do with what our members have told us. It's a reflection of the small business community.

NFIB's Education Foundation has been doing empirical data research for 22 years and for 22 years, across the spectrum in small business, we have found that the number one, the number two, and the number three top problems in small business, they tell us, with the Government, are IRS, the IRS, and I think the third was the IRS. Fourth comes in OSHA, and this is of long-standing, Commissioner. IRS comes in first. We have OSHA, EPA, et cetera.

Therefore, we're here today to talk about the most pressing problem in small business since outside of dealing with the Government, cash flow has always been our top three problems. When we look at the receivables and problems we have with the accrual system, accounting systems by the IRS, it's very understandable.

The small business community has been asking for relief and help and I want to applaud and compliment the Commissioner and the President, in his March memorandum that says we do need to focus on this. Steps that you're taking could make a difference. Having someone within your agency who's going to help small business—we applaud you in doing that.

I wish we didn't have to hire people to help do that. I wish we could do it anyway without having to add more costs.

Commissioner, you mentioned the budget-cutting. I read yesterday's *Washington Post*, which they tell me you have to read, coming into this city, to read the *Washington Post*. It says that the IRS shelves its plans for audits from hell. I don't know if you noticed that or not but that audits from hell could have come from Main Street in Pulaski, Tennessee. That basically says because of the budget cuts, there will not be enough money to go line item by line item.

So, if you have four children, let's see the birth certificates. Let's see the children. Line item by line item throughout the whole program.

What concerns me is the last paragraph when Mr. Crenshaw said "The agency said it's looking for other ways to get the information it needs."

So, there's this threatening tone that the Commissioner does not intend, nor does the Congress intend, nor does the President intend, but the most feared part of government for a small business owner is the Internal Revenue Service.

Small business says the way to take care of that is not to tweak and change the Code. Since 1986 there have been over 4,000 changes in the Code and regulations. Not only is that incredible to imagine; I can't see, Commissioner, how in the world you and your employees were able to keep up, change, retrain so that when they go in to look at the 1987, '92 and '94 audits, and the rules were different every year, how we can expect the employees to keep up.

When you pick up one-sixth of the Code—

Commissioner RICHARDSON. No, the regulations.

Mr. FARIS. Excuse me—the regulations. One-sixth the regulations and you go through and you read it, try to explain why this is so convoluted. "If, after applying the rules of paragraph C(5)(1)(B)(21) and (2) of this section, the consolidated group still has financial statements of equal priority, the rules of paragraph C(34)"—of course, this is all alternative minimum tax, which shouldn't be in here in the first place.

Commissioner RICHARDSON. I would like to say I didn't put it in the Code, in defense of the agency.

Mr. FARIS. One of your predecessors, Shirley Peterson, former commissioner, tells me the same thing, that you manage what you're given. What we're saying is that we need to take the IRS code, all 5.3 million words of codes and regulations, and put it to sleep. It doesn't work. It's convoluted. Everyone around the country we talked to agrees to that.

Now, that's good but we have to have taxes to pay for the Government. Now, small business doesn't think we need as many taxes as we have and they don't think we need anywhere near the complexity, but we do know we need taxes, they need to have employees to collect them and to be sure everybody's paying their fair share. No loopholes with people scamming the game.

That's the reason we're working with the National Commission on Economic Growth and Tax Reform, which we call the Kemp Commission, since Jack Kemp's our chair, to try to come up with a positive system. It's one thing to be against something. It's another thing to say, "OK now, if you don't like that, then what's it going to be?" We're working hard at that. I'll have a report the first week in January.

But we do know that that debate will take years. What can we do right now? That's what we want to focus on. What can we do right now? I would suggest to you that one of the things we can do right now has to do with some of what you're already doing, and that is we can make this IRS a little more customer-focussed. Take more of the money out of figuring out how to write more penalty threat letters and get somebody to answer the telephone when you dial the 1-800 number.

I had the opportunity to sell my business 4 years ago and I'm still getting threatening letters from the IRS because of not turning

in my forms on my employees. My CPA turned everything in exactly the way it's supposed to be done 4 years ago.

Then I made a mistake on a tax return 2 years ago and I've gotten seven different letters telling me seven different ways to handle it. Each time I sent in the check they asked for. Now, the letter didn't have a date on it. The envelope doesn't have a date on it. You have no idea when the IRS sent it, but the date to comply has already passed when it gets to my mailbox.

Well, I might need to talk to Marvin Runyan over at the Postal Service about that, too, which is another agency that doesn't work real well for us, but the problem is the frustration. I keep sending in the checks. The last one was just \$84.20. I still don't know why I owed that but it's a lot cheaper to do that than the time it takes trying to get through and hire somebody to do that.

That's not what you want, Commissioner, it's not what the Congress wants, but that's what we have. Therefore, why don't we do some very specific things, and let me move directly to those.

I've already mentioned the number one solution that we have in small business and that is what we've got not only doesn't work; it doesn't work very well at all for anyone. My dad, in the service station business years ago, sometime when a car would be brought in to be repaired he said, "Son, what we need to do with this is lift up the accelerator pedal and put everything else in new." And I think here we need to not even keep the accelerator pedal. We need it all new, but it will take time to get that done.

So, why don't we do this. I join with you, Commissioner, in expressing your support for a good NFIB Member in Congress, John Christensen, who is supporting bill H.R. 1972 that clarifies the independent contractor status, which you want clarified and we do, because your different employees have different interpretations of what that is.

Sometimes we have an independent contractor and it's ruled they shouldn't have been; they should have been an employee. The independent contractor has already paid taxes, but yet there are still fines on the small business owner.

We need to remove the threat and the fear so that the job can be done much more easily and compassionately. Pass regulatory reforms contained in H.R. 9, especially the Regulatory Flexibility Act reforms. Pass the Taxpayer Bill of Rights. The final rule on the Paperwork Reduction Act should be reformed, the one that you mentioned a while ago, so the IRS must comply. Quite frankly, you're exempted from the Paperwork Reduction Act. You don't have to be. You can voluntarily do that, and I applaud you for what you're doing.

Commissioner RICHARDSON. We do.

Mr. FARIS. We do believe, from your organization, to continue your efforts to encourage amicable resolution of disputes to try to get it out of the shouting matches, out of the attorneys' hands. With all due respect to your degree and reputation as a reputable attorney, but we need to keep it in the hands where the peer review boards can help it, where small business owners are involved.

I applaud you for supporting commissions which you've set up to give you advice and input from the small business community; the IRS Small Business Affairs Office, to seek the assistance of the

small business associations, such as NFIB and others represented here today and others not represented, in fully addressing what these regulatory actions do.

The bottom line is we must address a major change in how we go about collecting revenues from our citizens to pay for our Government. The time has come to stop complaining about the IRS and to start doing something about a brand new code and system.

During that debate I encourage the Congress and encourage the Commissioner in efforts to simplify, to make clear, to help us not be so fearful of our own Government. Be more customer-focussed.

We do need to get more and more bureaucracy off our back and out of our pocket so we can do what we do best. We can create jobs, build an economy, continue to contribute in the communities of America so that free enterprise and a free society can continue to grow and flourish. By doing so, we'll have more revenue, which we hope less will be needed to run our Government.

Madam Chairman, thank you for having me here. I look forward to the continuing dialogue. Thank you.

[Mr. Faris' statement may be found in the appendix.]

Chairwoman MEYERS. Thank you very much, Mr. Faris, for those suggestions.

The next person will be Jeff Joseph, who will take about a minute to introduce Mr. Ken Wolfe of Wolfe & Associates, Park Hills, Kentucky. He will be speaking for himself and, of course, for the U.S. Chamber. Mr. Joseph.

#### **TESTIMONY OF JEFF JOSEPH, VICE PRESIDENT, DOMESTIC POLICY, U.S. CHAMBER OF COMMERCE**

Mr. JOSEPH. Thank you, Madam Chair, members of the Committee. As has been indicated, I'm Jeff Joseph, vice president for domestic policy at the U.S. Chamber. We're always pleased to help this Committee hear the views of small businesses.

Of the more than 215,000 dues-paying members we have, in addition to the 3,000 State and local Chambers and 1,500 associations, 96 percent have fewer than 100 employees and 70 percent have fewer than 10.

Just as small business is the backbone of the economy, it's also the backbone of the U.S. Chamber.

As Mr. Faris mentioned, when you start talking with small businesses, taxes immediately leap to the forefront. As a result of a research survey, partial survey we did of our GAIN members—Grassroots Action Information Network members—6,000 small business people registered their concerns about their taxes and capital gains comes to mind. They favor expansion of the home office deductions and IRA's, the self-employed health insurance deduction, increased expensing allowance, reform of the AMT, estate and gift tax, and S Corporation rules also.

As already has been indicated, the independent contractor provisions, additional Taxpayer Bill of Rights provisions and, of course, overall simplification of making their life possible in terms of dealing with the IRS.

So, the hearing today is clearly timely on topics that small businesses care about very deeply. As a membership-driven organization, we work all the time with business people from around the

country who give us the guidance that we need, and I have next to me Ken Wolfe, who's a member of both our Taxation Committee and our Council of Small Business.

A practicing CPA from Fort Mitchell, Kentucky, he will give you firsthand information from the trenches on what's going on out there and, as has been indicated earlier, Ken was a delegate to the White House Conference on Small Business and he'll offer some thoughts on that.

So, thank you, Madam Chair, for the opportunity to be here, and Ken will now give you the message.

[Mr. Joseph's statement may be found in the appendix.]

Chairwoman MEYERS. Thank you, Mr. Joseph, and we're glad to have you here, Mr. Wolfe. If you would make sure that you speak directly into the microphone.

**TESTIMONY OF KEN WOLFE, KOHLHEPP, WOLFE & ASSOCIATES, PARK HILLS, KENTUCKY, ON BEHALF OF THE U.S. CHAMBER OF COMMERCE**

Mr. WOLFE. Thank you. Thank you, Mr. Joseph, Madam Chairwoman and members of the Committee. I want to thank you all for inviting me here today.

As this Committee well knows, small business is the economic engine of our economy. Today I would like to speak about the effects of unnecessary regulations on that engine.

It has been my observation over a number of years that the regulations currently being issued by IRS is more and more taking on the force and effect of law. The Congress is stating in the laws that they're writing that the Secretary shall prescribe regulations. This does, in fact, give those regulations the force and effect of law.

This limits the small business owner or small business taxpayer from taking a different interpretation based on their particular tax circumstances. They are forced into more compliance with the IRS's position.

In addition, the regulations that are being issued, as the Commissioner did note, are being issued quite late and it seems, as a matter of principle, that the tax law should not become effective until at least we have the second piece of the tax law, which is the regulations.

Currently what's happening is the law is on the books, it's effective, the regulations are not in existence or proposed or temporary, and we don't know exactly what we're supposed to do to comply. Then we have the effect of 20/20 hindsight after the final regulations are issued that we should have done it this way.

In the President's memorandum for heads of departments and agencies dated March 4, 1995, he directed those departments and agencies to focus on four steps which are an integral part of the regulation reform initiative. They are to cut the obsolete regulations, reward results and not red tape, establish grassroots partnerships, and negotiate, don't dictate.

Since March 1995 I've made a few observations regarding IRS, and these are the positive ones. There has been a softening of some of the language in the IRS's notices. They are allowing for the fact that you may not owe these taxes, and that's a positive step.

There has also been a small increase in responsiveness via telephones. When you call in now they do ask how many times did you get a busy signal, and so it appears that they are trying to work on that and solve that problem.

We still have the occasional, particularly over the telephone, the occasional IRS person that is demanding payment and wants to know when you're going to pay the notice, regardless of whether, in fact, you owe it, as the notice has indicated.

We also have a concern or I also have a concern that as the IRS districts are reduced, we find it's becoming more and more difficult to communicate, particularly with time zone changes but also just regional variations in how people deal with business and taxes. These are some improvements, small improvements, but a step in the right direction.

As mentioned by our Chair today, and just to recap those, the cost to small business of complying with unnecessary regulations is significant—5 billion hours at \$50 an hour equals 250 billion hours. Although I might get paid a portion of that, it is my opinion that my time could be better spent helping small business to be more profitable so, in fact, we would pay more taxes and thereby move forward.

Some of the areas that I see that we've had a worsening in regulations is office in home. Office in home was for years interpreted to be your primary place of business and used exclusively. Since recent court cases, my recent meeting with an IRS person within the last 20 days indicates that we now have to meet customers at that location. So, the line seems to have changed as to what we have to do with office in house.

The other areas of regulations that could be improved is on allocation of taxes paid. Currently we're in a situation where penalties and interest are significant, significant costs to the small business taxpayer. So, it's not unusual when a taxpayer gets an IRS notice that you might want to leave some taxes on deposit. The way that would normally occur, this would be 1994, we would get a notice on 1992 tax return, so we'd look at that, we'd look at the issues the IRS has raised, and we'd say, "Well, there may be an issue here where we're going to have to pay some, so let's leave a portion of our 1994 taxes on deposit."

Then you go through the process. You resolve the matter and, in fact, there might be some taxes due. By leaving the taxes on deposit with the Government we should be able to mitigate our penalty and interest. You had the money, and all we're going is transferring out of the 1994 account back to the 1992 account.

That seems very, very difficult for the Service to do. In fact, they mainly tell you you can't do it. Now, upon insistence, they will do it but it seems to me that that area could be improved and would be a benefit to the small business taxpayer, again, to mitigate their penalty and interest exposure.

The other areas that I have concern with are payroll taxes. We used to have a fairly simple system. If your taxes were less than \$3,000, you'd deposit them by the 15th of the following month, and if they were more than \$3,000, you had 3 banking days to make the deposit. That was a pretty simple system and everybody pretty well understood it.

If there was to be a change, in my view, the change should have been to move the \$3,000 to 5 or 7, make it easier for small business, but it did not. It went the opposite way. Now we're into one-eighth semiweekly payments and there's a look-back rule and it's got small business very confused, and it generates a lot of penalties which, in small business's view, is just another taxation.

I mean, if you really want to simplify it, just have everybody deposit them within 3 banking days. It doesn't help my cash flow but it does make it clear and concise as to what needs to be done.

The Commissioner did mention that we're moving more to electronic filing. I think that's a benefit, although we do need to recognize that not all small business is computerized and that can create additional problems.

As Mr. Joseph noted, the GAIN survey results indicated what I experienced at the White House Conference on Small Business, which was held in June here in Washington. Capital gains, expansion of home office deductions, estate and gift tax reform—those are all very important to small business. We need to focus on those and we need to make improvements on those.

Currently what I think is important to small business is presently the economy is growing at about 2.9 percent. The issue for this Committee and I think for Congress and the Commissioner to consider is how can we change tax policy, how can we change and simplify and eliminate regulations to have a 5 percent growth in this economy with no inflation?

Small business is ready to do its part. I ask Congress and this Committee for your help.

Chairwoman MEYERS. Thank you very much for your excellent testimony, Mr. Wolfe.

Our next witness is William P. Fisher, executive vice president of the National Restaurant Association.

#### **TESTIMONY OF WILLIAM P. FISHER, EXECUTIVE VICE PRESIDENT, NATIONAL RESTAURANT ASSOCIATION**

Good morning, Madam Chairwoman, members of the Committee. Thank you for inviting me here.

I am Bill Fisher, the Executive Vice President of the National Restaurant Association. Our association represents the U.S. food service industry, an industry made up of nearly 740,000 units and dominated by small business, nearly three out of four eating and drinking places of annual sales of under \$500,000.

Last year we participated in the Small Business Forum on Regulatory Reform co-sponsored by the U.S. Small Business Administration and the Office of Management and Budget Office of Information and Regulatory Affairs. At that time we highlighted a problem of increasing concern to many food service operators. This involved the IRS's interpretation of an income tax credit available to restaurants for FICA taxes they pay on tips above the amount of tips used to satisfy minimum wage requirements. To date, the IRS has chosen not to address this problem.

Let me provide some background, if I may. The provision in question, included in the 1993 tax bill, passed with solid bipartisan support and established what is now known as the Section 45B income tax credit. Several months after the legislation was signed

into law, the IRS issued a temporary regulation significantly altering the way the credit is applied.

The statutory language is clear. It authorizes the 45B income tax credit for, and I underscore this, any tax paid—double underscore—any tax paid by the employer during the taxable year. The statute does not restrict the credit either because the FICA tax paid by the employer is based on previously unreported tips or because those tips were received prior to January 1 of 1994.

If the employer pays FICA taxes after December 31, 1993, the statute allows the employer to take a business tax credit. Yet the IRS's temporary regulation, codified in Section 145B-IT, usurps the congressional authority and intent by restricting the 45B credit in just that way.

Part of the regulation permits the credit only for reported tips, as distinguished from unreported tips while Part B additionally restricts the credit only to tips received by an employee after December 31 of 1993, and not before.

The IRS's effort to limit the 45B credit to taxes paid on reported tips received by employees after December 31, 1993 has generated problems from the beginning. Last year, shortly after the IRS released its temporary regulation, a bipartisan group of more than 100 members of your body, U.S. Congress, wrote to then-Treasury Secretary Lloyd Bentsen to tell him the IRS interpretation was wrong. Let me read an excerpt, if I may.

"Congressional intent is clearly embodied in the statutory language, which provides the credit for FICA taxes paid after December 31, 1993." The signatories went on to make a request of Secretary Bentsen. "We strongly urge you to direct the IRS to issue new regulations that would not alter the meaning embodied in the statutory language in any way." The lawmakers who signed the letter included the original authors of the 45B credit.

Yet the IRS continues to refuse to implement the law as written, and that is why I am here today. In short, not only does the IRS refusal conflict with the plain language of the statute; it also means tens of thousands of small restaurant operators continue to live in jeopardy of back tax bills that could literally wipe out their businesses.

Operators are caught in a dilemma. Under the Fair Labor Standards Act, all tips belong to the employee. The employer is neither authorized nor allowed to report tips on behalf of the employee. However, the Internal Revenue Code holds an employer liable for the payment of FICA taxes on unreported, as well as reported tips. Thus there are instances when an employer is made to pay additional FICA taxes because employees underreported their tips.

The threat of back taxes is severe. An employer who has fully complied with the law, who has explained to employees their obligations under the law, collected tip reports from employees, as required, and paid all taxes due on tips can find itself, years later, with a tremendous back tax bill. This can be financially devastating to an employer, whose profit margins typically run between 3 and 5 percent.

Not only do these employers find themselves with a huge and unexpected tax bill under the IRS's interpretation; they are prevented from taking the business credit Congress intended under 45B.

The audit threat is compounded by the IRS's audit methods. In the vast majority of these cases, these back tax bills are presented to the employer alone. In most cases the IRS never contacts the employees who failed to report the tips and never collects the employee half of the FICA tax, and never credits the payment to the employee's Social Security wage history accounts.

Leaving aside these difficulties about the IRS' audit tactics, however, the 45B statute provides a tax credit when these audits occur. This is not only consistent with the language of the statute but with related parts of the tax code. Section 3121(q) of the IRS Code, which gives the IRS the right to collect the employer share of FICA taxes on previously unreported tips, specifically notes that these taxes are not deemed to be paid until the employer receives "notice and demand" from the IRS.

This provision, in effect, treats unreported tips from previous years as if they were reported for employer tax purposes in the year the employer receives the notice and demand. The 45B FICA tax credit was designed to give a business credit consistent with this intent.

Given the consistency of the 45B credit with related provisions of the Internal Revenue Code and the strong congressional support for the statutory language, we encourage Congress to make certain that the IRS enforces the law as written. In fact, the House Budget Reconciliation Bill includes language which effectively overrules the IRS regulation. We applaud the Ways and Means Committee for including this important provision in the legislation.

Finally, I would like to make it clear that the National Restaurant Association does not condone, ever in any way, any underreporting of tip income or any attempt to evade taxes that are owed. However, the IRS' restrictive interpretation looks to us as if the agency is attempting to accomplish through regulatory fiat something that expressly contradicts the statute.

Whether or not the IRS likes the statute, the fact remains that the statute is the law. The IRS must not be permitted to change the statute's application to tailor the credit to its own ends.

Thank you for having us here today.

[Mr. Fisher's statement may be found in the appendix.]

Chairwoman MEYERS. Thank you very much for being here and I think that helps us understand your concerns.

Our final witness is Bennie Thayer, president and chief executive officer of the National Association for the Self-Employed. Welcome, Mr. Thayer.

#### **TESTIMONY OF BENNIE L. THAYER, PRESIDENT AND CHIEF EXECUTIVE OFFICER, NATIONAL ASSOCIATION FOR THE SELF-EMPLOYED**

Mr. THAYER. Thank you so much, Madam Chair. It's my pleasure to be here. Mr. LaFalce and other members of the Committee, my name is Bennie Thayer. I represent the National Association for the Self-Employed, presently representing approximately 350,000 members across this Nation. We are the newest kids on the block. The association is only 11 to 12 years old in terms of representing small business.

I had not intended to allude to a personal story; however, after hearing my peer, Mr. Faris, give his down there, I think that, Mrs. Richardson, to really have you understand what we are trying to say here today, it would be important to relate, quickly if I might, a personal story, since it is most recent.

Approximately 3 months ago I had one of the revenue officers knock on my home, leave a card with my wife and ask that I give them a call. I gave that revenue officer a call the following day and was told that I needed to come in immediately because I owed taxes dating back to 1985 and '86 relative to a partnership that I had left.

The young lady that I spoke with, I said, "Well, I left that partnership. Your records will probably show that I left it in the hands of a partner who continued to run the business." She said, "Yes, but did you officially withdraw?" Like most small businesses, I did not. She said, "You're still liable."

I said, "Well, have you attempted to collect from Mr.—the gentleman who was a partner at the time?" She said, "No, he's dead." I said, "Well, I just saw him about 3 weeks ago and at that time he was very much alive." She said, "Would you give me the phone number and how we might get in touch with him?" I said, "Well, I would think that the IRS should be able to do that."

To make a long story short, she called me back. I went in. She told me that they had called the gentleman. He was unable to pay and it seemed that I could pay and I was liable. I chose, that day, to go in wearing a jogging suit.

I must say to you I think Mr. Faris really hit the nail on the head. One of things that you obviously can do to accomplish small business feeling a lot better is possibly increased sensitivity training in terms of your employees. I, in going in that day, felt that indeed I was walking into a jail scenario because of not what was said but how it was said, not what was done but how it was done.

The end result of that was that approximately a week or so later I chose, told them that I would pay the amount, some 5,000 plus dollars. I was called by my finance officer of the NASE and told the day after I was to go in and I had called and said that I couldn't get in that day. I was told that there was a lien or a garnishment that had been sent to the NASE on my wages for that amount.

I immediately dropped everything, went out to the IRS and paid the amount in full. No penalties were relieved. No interest was relieved.

I think this is what we're talking about. I chose not to even bother to write a letter asking for relief because I had had it as a result of that.

We're talking about real situations here, and that's what I'm here to represent today. I think that you have brought a change and you have shown that you're willing to bring that change. I applaud your representation at the White House Conference. I would ask that you continue that.

I would like to just relate some specifics, if I can, here today, and I'll be as brief as I possibly can. We certainly want to thank Mrs. Meyers and other members of the House Small Business Committee for vigorously promoting legislation this year to reform the Regulatory Flexibility Act.

We're also pleased that the Clinton administration has lent its support to strengthening the RFA. But to accomplish this, the RFA must be a law Congress and constituents can depend upon. Unfortunately, that has become less true over time. Many agencies and particularly the IRS routinely ignore the congressional intent behind the enactment of the RFA in 1980. In fact, it is a fact that the Internal Revenue Service now claims that it is entitled to a blanket exemption from the RFA.

The Regulatory Flexibility Act has enjoyed strong support because it is a responsible approach to a very real problem. For Members of Congress, the act can provide a channel for turning constituent complaints about the bureaucracy into constructive solutions, we believe.

Therefore, when Congress acts on regulatory flexibility reform legislation over the next few months, and we certainly hope that they will, that legislation should mandate that all agencies, including the IRS, be subject to judicial review.

The President's National Performance Review calls for the implementation of a small business tax and wage reporting system or STARS, which you are familiar with. I'm pleased to say that the NASE was very much a part of that over the past 2 or 3 years and we indeed sent a representative there to be a part of that.

In the recent report released by the National Performance Review payroll recordkeeping regulations are the most burdensome concern of businesses with 10 or fewer employees, and these are the people who we represent, those with 10 or fewer employees. The report said that 79 percent—this was true for 79 percent of American businesses.

In general, the STARS initiative will ultimately enable employers to file W2 data through single returns filed electronically, as you have alluded to, with both the Federal and the State governments. We urge the administration and Congress to take the critical steps necessary to foster Federal-state cooperation toward implementation of this program over the long term, including implementation of pilot programs between the Federal Government and the various States.

A central theme of any investigation involving IRS regulatory burdens should include a review, as has been alluded to, of the independent contractor issue. The small business community has long supported clarification of IRS rules and regulations relating to the independent contractor status. This support has been largely fueled by the vigorous and intense IRS payroll tax audits over the past few years which have focussed on employment classification issues.

We understand that in the vast majority of audit cases, the IRS has reclassified the independent contractors as employees. If that is indeed true, certainly it needs to be looked at.

In testimony before the House Small Business Subcommittee on Taxation and Finance, the IRS announced three initiatives designed to improve the agency's administration of the law and regulations involving independent contractors. These initiatives stress a more national focus, Mrs. Richardson, and coordination with regard to IRS enforcement in the area of independent contractor audits.

While the NASE—and I really mean this—we applaud the stated intention of these initiatives, we're extremely skeptical that the initiatives will ease the burden on small business when faced with an independent contractor audit.

We believe that the best way to improve the situation for independent contractors is to indeed enact H.R. 1972. The bill strikes a positive balance between the needs of the small business community, the Nation's economy, and the tax administration process.

In closing, I would like to briefly touch on the issue of the home office tax deduction. We are well aware of the work of the Small Business Committee on this issue and we certainly applaud it and how it worked very closely earlier this year with the Ways and Means Committee to obtain inclusion of a home office deduction reform provision in the House's Contract with America.

Home office deduction reform is needed to ameliorate the economic hardships caused by the 1993 U.S. Supreme Court decision in the Commissioner versus Solomon case. The Finance Committee last week passed the revenue component of the Senate's 1995 Budget Reconciliation Bill and unfortunately its package does not include a home office deduction reform provision.

The NASE strongly urges the Small Business Committee to continue its critical work on behalf of home office deduction reform. We recommend that the Committee work aggressively to ensure inclusion of the House's home office provision in any final budget reconciliation budget agreement.

I thank the Committee for inviting me to testify today. I thank Mrs. Richardson for indulging my remarks and indeed, my brief experience. It has been my pleasure, Madam Chair, to testify.

[Mr. Thayer's statement may be found in the appendix.]

Chairwoman MEYERS. Thank you for being with us, Mr. Thayer. I'm going to ask a question and try to keep to less than 5 minutes.

Let me say that we have a little show and tell here today. Over to my left you see three stacks I asked my staff to put together. The first stack is the Internal Revenue Service Code. The second, larger stack is all the IRS regulations implementing the Code. The third stack represents the approximate pages of regulations that the IRS has identified for elimination or reinvention pursuant to the President's March 4 directive.

My first question relates to the 30 obsolete regulations and 160 pages in the Code of Federal Regulations, which the IRS proposes to withdraw as a result of the page by page review. Will this withdrawal result in any burden reduction for the public, or are they just obsolete rules that have not been enforced? Is there going to be a significant burden reduction because of that third stack there?

Commissioner RICHARDSON. I will have to get you, for the record, Madam Chair, what the estimates are. I don't know, based on the measures that seem to be traditionally used, what the estimate is.

But I would like to point out that the Internal Revenue Code, which is on the left-hand side of the stack, is made up of statutes that Congress passes and the regulations in those volumes beside it are interpretive regulations. They are not legislative regulations, like many agencies are authorized to enact. I think that makes a significant difference when you're talking about burden reduction in my ability and in my agency's ability to reduce the burden.

I mentioned in my opening statement that a lot of our focus has been to try to reduce paperwork and to move into electronic filing. Some of the things that have been pointed out here are issues that we are either working on or—actually, I think most of the items we're actively working on. But virtually all of those regulations in those many volumes are an attempt to try to interpret or carry out the requirements of Congress.

So, it makes it very, very difficult, when the statute itself is complex or lengthy, for us to do much more. It isn't like we're imposing statutory requirements or legislative requirements.

Chairwoman MEYERS. It seems to me that that's a great deal of interpretation, however, and I know that the IRS has historically used the argument that those rules are interpretative to avoid the reg-flex considerations for small business. As you well know, regulatory flexibility requires an agency to do an estimate or an evaluation of any new rules and regulations for their impact on small business. The IRS has said, "Well, we don't have to do that because ours are strictly interpretative."

It just strikes me that there's a great deal of discretion involved in those interpretive rules that could greatly influence the paperwork and the regulatory burdens of small business.

Do you have someone who focuses on trying to particularly implement rules that would take into consideration the problems of small business?

Commissioner RICHARDSON. Very much so. I would like to correct the record. In 1988, when Congress was looking at the Regulatory Flexibility Act, I wasn't commissioner then, but I understand the specific issue of whether or not the IRS should be covered was discussed and debated at length by Congress.

It was concluded that our interpretive regulations would not be covered. We do submit any legislative regulations, of which I acknowledge there are not a lot, but we do not take the position that we are totally exempt from the Regulatory Flexibility Act. We do submit and would submit any legislative regulations.

What we have done, though, to take into account the interests of small business, in addition to what I mentioned here today, is send all of our proposed regulations to the Office of Advocacy at the Small Business Administration and they comment on those regulations and their implications for small business.

Chairwoman MEYERS. Well, I appreciate your correcting the record on that.

Commissioner RICHARDSON. One other thing. Mr. Wolfe, I think, pointed out in his testimony that we needed to get regulations and more precise guidance out sooner.

One of the serious concerns that we've had, and I think the Congress had in 1988, was the fact that if the regulations were subjected to the Regulatory Flexibility Act, that would not allow the regulations to get out more quickly but indeed would slow them up.

So, there is a real tension, and I think Mr. Wolfe indicated and many of his colleagues would, as well, that probably getting guidance out sooner, with more specificity, is more in the interest of taxpayers, rather than slowing the process down.

Chairwoman MEYERS. Well, I appreciate your comments very much.

Mr. Faris, did you want to comment?

Mr. FARIS. I would like to comment on that. One of the big problems that small business has with our whole tax system is we have no confidence that there will be any stability, no confidence that we'll get any straight answers that we can rely on for any period of time.

So, if it takes 3 to 5 years to come up with some regulations, we think that may be too quick. What we'd like to do is to have a system put in that would require a three-fifth majority and/or a national referendum to raise the percentage of tax or to add one deduction, so we can depend on what the tax system is going to be.

Quite frankly, this is not exactly bedtime reading for any of us, including the Commissioner. So, even when the regulations come out, if they come out quickly, we still don't feel that we're that better off.

So, what we're saying is a convoluted system that requires this Commissioner and her employees to be able to understand, grasp, interpret and then give opinions based on what's on that table is not fair. It's just not fair. But until then, we can do what Mr. Thayer suggested. We can have a system that's a little bit more customer-focussed.

I like this resource kit; I just think it's a shame that we have a tax system in America where you've got to have a huge resource kit just to try to help understand the basics of figuring out how much I make and what I can deduct and what I have to say.

Some of our members have said that they feel like there's a new system, a simpler system. You put one line, everything I make. Line 2, send it all to IRS. Line 3, they'll send back what they don't need. We don't need that simpler system, right, Commissioner?

Commissioner RICHARDSON. I would like to point out that although the checks are made out to the Internal Revenue Service, we do not get any of that money directly. So, it's funding the Federal Government's efforts.

We, too, would benefit from stability and I think that one of the concerns that a lot of people, and probably frustrations they're expressing, is that there were a number of tax law changes throughout the 1980's and, as a result, people had become comfortable with a provision or came to count on it, including us as administrators, and the next year or 2 years later, something was changed.

We would laud the opportunity for stability, as well. It's important for us. But I do want to point out I don't write the tax laws and I—

Mr. FARIS. You just wear a badge, right?

Commissioner RICHARDSON. It's very much, I think, an accurate statement. I've said often if people don't like the system they should be talking to you and your colleagues. If they don't like the way we administer the system, they should be talking to me.

That's what I really do want to emphasize. We are trying to listen. We are trying to improve. Many of the concerns about notices, bills, statements that are inaccurate are largely attributable to the fact that we are dealing with 1960's technology. It is strung together in many ways with chewing gum and bailing wire. Any stress that's put on our processing system—through tax law changes—makes it very, very difficult for us to be able to do the

kinds of things we'd like to do, and that is process returns accurately, timely, and have information basically processed in real-time.

Mr. FARIS. This is a great day, Madam Chair. We've heard the Commissioner of IRS is supporting two things that are very important to small business. One is the Christensen bill.

Commissioner RICHARDSON. No, I am not supporting the Christensen bill and I want to make that very clear. We're very concerned about the Christensen bill, as is Treasury, and I believe they've testified, because it has very vague standards in it and basically does nothing to accomplish what all of us want to do. And that is to find very clear and objective standards for defining an "employee" and an "independent contractor."

Chairwoman MEYERS. I have to move on because there are other Members but I would like to know, Ms. Richardson, what you would suggest in place of the Christensen bill. Maybe you've already stated that, but if you could get that to the Committee in writing, and I will yield at this time to Mr. LaFalce.

Mr. LAFALCE. Thank you very much, Madam Chair.

Well, I think this has been an interesting venting session. I think we have some problems with the whole concept of service in our society, and I think it's applicable to the private sector and to the public sector. We need to work on it.

It's tough to find businesses today in the private sector that give good service. They've taken the fast out of fast food restaurants very often, it seems to me. You go because you want to buy a car and you ask them to send you a brochure as soon as the brochures come in, and all of a sudden they don't do that. You ask them to find out what type of cars are available within the area and get back to you. They don't do that.

I could give countless examples of the difficulties of dealing with people who are supposed to be involved in service in the private sector, and also in the public sector. Every day I have to listen to my wife telling me the difficulties she's had with people who are supposed to be working on one aspect or another of our home, et cetera.

In the public sector, too, that's a problem. Whenever I go into the airport from abroad—New York City, for example—and I see the Customs officials and the immigration officials and the way they treat people as they enter, I say, "Oh, my God," 99.99 percent of these people are not smugglers or dope addicts or what have you and we should be treating them better.

Yesterday I was in one of my district offices in the morning and I listened to one of my case workers on the phone and I said to myself, "We should be speaking more kindly, more gently to this person with a problem than this particular caseworker was." Then I got a note from the caseworker that this is the same person who has called every half hour on the half hour for the past several weeks and I was a bit more understanding. I also realize, though, how that can also affect her delivery of service to other constituents and her attitude towards other constituents.

So, this is a problem that we have to deal with and I think periodic hearings like this can achieve some good because they can make all of us realize the importance of service. We're concerned

now about Government service and the IRS in particular, and that is the biggest headache. Why? Because people are giving up money that they'd rather not give up but they're giving it up involuntarily. They're giving it up under mandate of law.

That law can be interpreted a million different ways. Not even a million different ways. If there are 250 million people in America, 250 million different ways.

Of course you have a lot of IRS people working for you, trying to apply the law as interpreted, hopefully monolithically by the IRS, but they probably apply it differently, too. So, you might go to a different IRS office in San Francisco, in Buffalo, et cetera. I know—was it Money Magazine? Every year they go to private accountants and the private accountants are told to prepare the tax returns. If there are 100 private accountants, they usually come up with 100 different tax returns, and they vary in how much the taxpayer will pay from whatever it is, \$100,000, to \$10,000. That's a big variation, and it's one law we're dealing with.

So, we have to have to provide some uniform interpretations of those laws. Of course when you come up with interpretations of those laws, in an effort to provide uniformity, in an effort to be fair, you wind up with more pages.

There's a tradeoff, isn't there, between the specificity that you would detail for each and every law in order to achieve uniformity and therefore equity, and simplicity. I suppose that if you had simplicity in interpreting the law, and of course we have different statements, too. Mr. Faris at one time said "We've changed the law a million and one times; let's not change it anymore." Then, of course, "Let's have a huge, enormous change." There's a little bit of an inconsistency in some of the things you said.

Mr. Wolfe, you said, "Gee, this is a terrible thing we have going on now. The law says that the Secretary may prescribe regulations and there's something wrong with this because this therefore gives it the effect of law." Well, if the Secretary were not given the ability to prescribe regulations, what a mess we would have indeed, if no regulations could be prescribed. If they wouldn't have the force of law, that would be a bit of a problem, too, wouldn't it? You wouldn't be able to have enforcement.

Let me get down to some questions. Ms. Richardson, you've gone from \$25 a day to \$75 a day and you require no documentation for the \$75 a day. Is that correct?

Commissioner RICHARDSON. That's correct.

Mr. LAFALCE. But shouldn't you be doing things the way the business community does it? I wonder if the business community—the Chamber of Commerce, the NFIB—require documentation or have a rule that says we need no documentation for expenses of less than \$75 for our employees.

Mr. FARIS. The specific answer for that for us is that we ask for documentation of all reasonable expenses that are paid, with an understanding that if you have to catch a cab and get to the Hill and it costs \$4 and you have to stop and get a receipt every time you do that, you're going to end up getting a pad of receipts and filling them out.

So, that's just a common sense response. But if you have a receipt for going through a toll booth and it's a dollar, then we want to see the receipt. It's just to keep everything honest and clear.

I think the \$75 rule, we applaud. We think that's—

Mr. LAFALCE. Well, I know you would applaud it but I would think that it's much more generous, much more liberal, much more flexible than most businesses. In the same Wall Street Journal article that I believe you read, I think they said most small businesses demand much greater accountability from their employees before they would reimburse their employees. I know they do in the House of Representatives. We couldn't come in and say we have general expenses of so much. We have to, if we buy a newspaper for 50 cents, have a receipt for the 50 cents.

I'm just pointing out that—

Mr. LONGLEY. Would the gentleman yield for a second?

Mr. LAFALCE. No, I will not. Thank you.

I think that you've taken a great step forward, Ms. Richardson, and you should be applauded for it. My time has expired.

Mr. FARIS. Excuse me. The follow-up is that the small business owner that's keeping up with the detail also doesn't threaten fines and imprisonment to the employees. There's a huge difference, a huge difference.

Chairwoman MEYERS. Mr. Torkildsen.

Mr. TORKILDSEN. Thank you, Madam Chair. Thank you, Commissioner and all the witnesses for their testimony today. I'm going to try to get in four subjects in 5 minutes, so we'll do this very quickly here.

First, to follow up on the question about the Christensen bill, does the Treasury Department have any recommendations at all? I served as commissioner of labor and industries for Massachusetts so I had to deal with this problem about contractor versus employee, and there's not an easy solution. Does Treasury have any suggestions that you're aware of?

Commissioner RICHARDSON. I think that probably Mr. Samuels and I should come and visit with you, if we could, and talk to you about some of the issues that are out there.

Mr. TORKILDSEN. I think we would all appreciate that because clearly employers are between a rock and a hard place, depending on what definition you encounter.

Commissioner RICHARDSON. There are many ramifications, not just tax issues. As you well know from your prior experience, it has to do with pension benefits and health benefits and a whole host of items.

Mr. TORKILDSEN. Workers compensation for the State level, the whole bit.

To follow up in that area, and this is one area that I was able to contact your office in advance on, a number of small bank owners and presidents, have pointed out that oftentimes they're between a rock and a hard place on interpretations from different Treasury agencies. In this particular case, the Office of the Comptroller of the Currency would come into a small bank and say, "A loan on your books is a bad loan; you should write it off, declare it as a loss, and so it doesn't show up on your statement." Then

the IRS will come and audit 6 months later and say, "Well, you wrote the loan off too soon; you can't deduct it from your taxes."

A larger bank wouldn't have that problem. Either they're not regulated by OCC or it's going to be a small blip but if you're a small community bank, having that problem is significant.

Is there any effort under way to make sure that all businesses, whether banks or other entities, only have one set of regulations from Treasury so that they can't be whip-sawed between two different interpretations?

Commissioner RICHARDSON. Mr. Torkildsen, I actually got your question fairly late last evening and I didn't have time to check back with our chief counsel. I will get you an answer right away. I do work with the comptroller and other Treasury bureaus and we are cognizant of trying to make sure that we are consistent.

I don't want to mislead you because I'm kind of vague on where that specific project is right now but we will get back to you in the next day or two, if you don't mind.

Mr. TORKILDSEN. That would be very much appreciated.

A third general area I wanted to talk about, and you did address a fair amount of this in your comments, Commissioner Richardson, and I'm cognizant that Mr. Wolfe had some concerns about it, but the whole nature of electronic filing. I think as long as it's an option, not a mandate, it's very positive, and I think probably the IRS is leading all the Government agencies in that area.

Are you at the point now where literally any filing can be done electronically or are you headed that way?

Commissioner RICHARDSON. We are definitely headed that way. There are still a few things that cannot be filed electronically, but we're working hard to try to solve those problems in the next year or so.

We do recognize that there are some small businesses that don't have access to computers or to the Internet and we're trying, and that's one of the projects that Barbara Jenkins, our small business advocate, has, is to find out how we can address those concerns, as well.

But many of the things, including our TAXLINK Program, which I will leave brochures with you and your staffs for making the payroll deposits, are not dependent upon having a personal computer. That is only an issue of having a telephone and telephone access. We do feel that most businesses can be accommodated that way.

Mr. TORKILDSEN. Yes. As long as it's an option and not a mandate, I think it's positive and I would expect that the research you've done has shown a very positive response, and people are using it?

Commissioner RICHARDSON. Very positive. As people begin to use it and realize the error reduction—where we have electronic commerce, the error rate is less than 1 percent. Where we have paper processing, it's in the 15 to 19 percent range, some errors made by taxpayers, some made by us.

So, it's a significant burden reduction, if you will, not to have those errors in the system. What we're finding is as people begin to use electronic commerce, such as our TAXLINK Program, there's demand for even more. Why can't we have all our records submitted that way?

So, the private sector, I think, has been very receptive, and we're working with them to try to develop the standards so that what we do will accommodate their needs, and that we won't just put out requirements that can't be met.

Mr. TORKILDSEN. Well, I certainly applaud your efforts in that area.

The fourth subject I wanted to touch upon just in general, and I don't know if this was discussed in some of the testimony previously, the nature that individuals and small businesses may call up and ask for advice, going through the regulations. They may not be able to afford all the fancy lawyers you need to understand that and yet when they talk to someone at the IRS, there's nothing that says that that IRS employee's interpretation is in any way binding.

Is there any discussion under way so that there can be an answer that people can rely on? I understand the frustration certainly for small business and individuals both who call up and they get an answer and then if they find out that the answer's not correct, they're liable and not the IRS.

Is there some way to have a binding advisory service so that people can understand and fill out their forms with confidence that what they were told by the IRS is indeed correct?

Commissioner RICHARDSON. One point I wanted to make a little bit earlier is that the vast majority of taxpayers do not have to look at the Code of Regulations. That is why we have tax instructions and tax booklets. 70 million returns are 1040-EZ, which is—I'm sorry, 23 million, and 70 million are paying at the lowest rate.

So, a lot of people really don't have to deal with a lot of the complexity. I think 82 million people take a standard deduction, so they're not dealing with a lot of the complexity. Then a number of other people take one or two or three deductions—home mortgages, charitable contributions, and State and local income taxes.

But in response to your concern about our accountability for our answers, we published last year for the first time in our tax package and we have it again this year—it'll be in the 1995 packages that will be out at the end of the year—one of our customer service standards. That is, if you call us and get advice from us and it proves to be erroneous or cause you to incur penalties or interest, we will waive the penalties. We are not today legally able to waive interest, but we can waive penalties and we will do so.

On that point, though, I might mention—the Taxpayer Bill of Rights was mentioned earlier—we applaud those efforts. We worked with the Ways and Means Committee and we welcome the changes that are in the House bill on the Taxpayer Bill of Rights. We feel that there are some provisions in there that would be a relief to taxpayers in the penalty and interest situation.

Mr. TORKILDSEN. Thank you. My time has expired. Thank you for covering all four subjects, and I look forward to follow-up on—

Commissioner RICHARDSON. We will get back to you on the banking issue.

Mr. TORKILDSEN. Thank you very much.

Chairwoman MEYERS. You were very efficient with those questions, Mr. Torkildsen.

Let me say that the answers that you said to Mr. Torkildsen you would supply him, I wonder if you would supply to the Committee for the record—

Commissioner RICHARDSON. Absolutely, absolutely.

Chairwoman MEYERS [continuing]. so that we will have them available.

I'd like to say to other members of the Committee we'd like to have this be somewhat of a dialogue. It doesn't necessarily need to be adversarial but if you have a comment on questions that are directed to another member, feel free to comment. Mr. Wolfe, you looked like you were just dying to say something a minute ago.

Mr. WOLFE. I've been mentioned a couple of times. I just wanted to clarify my positions.

I am not in favor of the present system where the Secretary prescribes regulations to the Code. I am in favor of the tax committees, the Senate Finance Committee and the House Ways and Means Committee, writing law. If, in fact, IRS has their interpretation, that's fine. As a taxpayer and as a representative of small business, we think we are entitled to our interpretation and I believe that's why the court system is there, to make the final determination of which interpretation is correct, given the facts and circumstances.

We are precluded from that now by the way the law is being written, where the Secretary prescribes the regulations that, in fact, have the force and effect of law. So, not only do we have to know what's in the code books, but now we have to know what's in the regulation books and also follow those with very limited deviations, even though our fact pattern may appear to be different.

Chairwoman MEYERS. Well, I would agree with you, Mr. Wolfe, but I will say a lot of those are probably the fault of Congress. It's just that we write laws that are so general and instruct the agency to follow through with rules and regulations.

So, I think what you're saying is directed to us somewhat, too, in that the more specific we can be, the less interpretation there's going to have to be on the part of the agency.

Ms. Velázquez.

Ms. VELÁZQUEZ. Thank you, Madam Chair.

Mr. Faris, in New York we have a saying, "Don't leave New York without reading the *New York Times*."

Miss Richardson, I don't know if you had a chance to read this article yesterday?

Commissioner RICHARDSON. I did.

Ms. VELÁZQUEZ. It highlights the possible new burdens that the Republican proposals to make the tax bill a little smaller will bring. Particularly officials of the Treasury Department commented that if most of the current proposals were enacted, people would blame the Internal Revenue Service for something that is Congress's fault.

I just would like to hear your views, in terms of how would the IRS accommodate items such as medical savings account, changes in capital gains law, and altering the marriage penalty without increasing the length or complexity of the current form.

Commissioner RICHARDSON. Well, as I said earlier, I think we are often the surrogate for people's concerns about the complexity

of the Code and I do like to remind people I don't write the law. We try to administer it and at times it becomes fairly difficult.

I'm not precisely sure of all of the forms that were referred to in that article but what we do try to do is track provisions as they're being considered by Congress, and then comment to the Ways and Means Committee and the Senate Finance Committee on what we view as potential administrative problems or concerns.

We don't do tax policy. That is the province of Treasury and the Congress. But what we do try to do and what I feel very strongly about, as the head of an agency that administers the law, is that we'd like to make sure that people do understand that if there's a different way to do things that might make it easier to administer, it will also make it easier for taxpayers to comply, because when it's difficult for taxpayers to comply, it's frequently difficult for us to administer.

So, our efforts have been directed not just at the tax legislation pending today but at all tax legislation whenever it's out there, to make sure that at least the administrative burdens are taken into account.

One thing that I am concerned about is any tax law changes that occur late in the year, that might be retroactive, can be very difficult because our forms are already at the printer. In fact, I saw the tax packages yesterday for next year. So, if they're wide-ranging changes, it would be very difficult to administer.

Ms. VELÁZQUEZ. Mr. Faris, do you have any comment?

Mr. FARIS. She got my heart going saying that she'd already seen the forms that are going to come out next year.

We know that the EZ forms—

Commissioner RICHARDSON. That's because there weren't many changes.

Ms. VELÁZQUEZ. I would like to hear your comments on the Treasury official's view that the tax plan, the Republican tax plan will raise the burden in terms of the forms, the complexity and the length of the forms.

Mr. FARIS. Well, I think it's no surprise that when the Republican Congress wants to change something that the Democrat administration would find problem with it. So, I don't see that as a very unusual situation.

I do believe that when it comes to the problems and complexities of reform and change, that in order for us to get fairness and more simplicity, we don't think, from our view as the small business community, some of the changes, in order to get us some help, are minor changes and they generally are less voluminous in reports and regulation.

Not having the detail that the Treasury does, I can't comment on the specifics of the details. I just know that 40 percent—the comment a while ago about the forms—40 percent of the people who filed the EZ form pay people to file it for them, to figure it out, and it's a 24-page document to explain the EZ one.

So, when we go to change it again, every time we change it, and that's the reason that we need certain changes now but that's the reason I want everybody to just force and push through the fact that we need major tax reform, so we don't have all these—

Ms. VELÁZQUEZ. We might need changes next year, too. Miss Richardson—

Commissioner RICHARDSON. Could I just respond to one point about that?

Ms. VELÁZQUEZ. Sure.

Commissioner RICHARDSON. A number of people do go to tax return preparers and I think it's a real tribute to small business that they've been able to convince people who they do need to use a preparer to have a 1040-EZ prepared.

Mr. FARIS. I'd sure like them to use that time to help them make better business decisions and hire more people and produce more revenue, than try to figure out how in the world to file our taxes with the Government. Let's take—

Ms. VELÁZQUEZ. This is my time, Mr. Faris, and I still have another question for Miss Richardson.

Mr. FARIS. Excuse me. I just get so excited about this.

Ms. VELÁZQUEZ. Miss Richardson, you mentioned before that the IRS now has all its forms on the Internet.

Commissioner RICHARDSON. Yes.

Ms. VELÁZQUEZ. What about small businesses in a community like mine that might not have access to the Internet? What is the alternative?

Commissioner RICHARDSON. Well, we have our taxpayer service and walk-in operations, which we have traditionally had but in all honesty, we are closing a number of them, given the budget situation. One of my biggest concerns for the next filing season is that we won't be able to provide the taxpayers with the kind of service that they need, both in terms of walk-in and the telephone traffic.

This past year we were funded to answer about 32 million calls through live assisters. We answered around 40 million. We project maybe 60 million calls next year, so I'm very concerned about it.

Ms. VELÁZQUEZ. Thank you, Madam Chair.

Commissioner RICHARDSON. I'm sorry. Someone just reminded me we are working with libraries. The CD-ROM's have all the forms on them. In local communities, we're trying to get the word out through libraries and public service groups, but we are in the process of closing many of our walk-in offices.

Ms. VELÁZQUEZ. It's very important that we keep that in mind. I guess that businesses like the ones that I represent in my district are not represented here today. Thank you, Madam Chairman.

Mr. THAYER. Madam Chair, I just wanted to make a comment. Ms. Velázquez, in deference and in all due respect, I represent quite a few businesses that are represented from your district. The businesses that I represent happen to be the Mom and Pops. They happen to have less than five employees, and I think that is a matter of record over and over again here.

So, we are representing the small businesses today.

I have one comment. Over and over again I've heard Commissioner Richardson state that the IRS has been cited for less regulations than any other agency, and it sparked me because we recently commissioned a survey of these Mom and Pops and these small businesses, in preparation for this hearing. The results of that was that 82.4 percent of the respondents said that the IRS was the greatest regulatory burden upon them.

So, obviously, and I am sure that the Commissioner has the back-up for her statement, so it must be perception. I mean, what are we alluding to here for the difference in what the small business people say is happening to them and what the IRS is saying we're perpetrating upon them?

Commissioner RICHARDSON. Mr. Thayer, I have spent most of my tenure trying to make tax administration better for all Americans, including small business, so I'm not trying to be unresponsive, but we are the one agency that probably touches the lives of almost everyone in this country. That gives us a special responsibility, a special obligation, and I think a special opportunity.

I would say that of all the Government agencies, we're probably the only one that deals with almost every taxpayer or every small business. So, it's not surprising that we're the top three on the list Mr. Faris mentioned. Many businesses and individuals never deal with any other Government agency, so I wouldn't expect them to have concerns about other agencies.

Mr. THAYER. But it's still, then—

Commissioner RICHARDSON. So, I think we have to put it in perspective, as well. I have 200 million customers out there, and I don't think any other agency can say that.

Chairwoman MEYERS. Just a comment, Mr. Thayer, and then Ms. Kelly will be our next person to ask questions.

I think the elements that were passed as part of the Contract with America that were left out of the Senate plan would be the two that might affect the IRS's regulatory burden the most for your members, and that is the home office deduction and the expensing provision, because if you have to depreciate or amortize over a period of years, that requires an enormous amount of paperwork.

So, I have already written, in the name of this Committee with a number of signatures from this Committee, to the Senate saying we hope that that can be added to the Senate bill, both of those provisions. So, anybody who wants to make a phone call to a favorite senator, why, I think that would help the smallest of the small.

Mrs. KELLY. Thank you. Thank you for being here, and I also want to thank all of you for speaking up and speaking clearly about this topic.

Miss Richardson, we are agreed that we must have stability in the tax system. It's desirable for the Nation. We have to work hand in glove to operate the Nation.

I think what I hear on the part of the other people is that there's a real plea to insert in what is happening between the tax codes piled up there and the regulations and the way they hit those of us in small business is some real common sense.

I think that along that line, I find the tax codes remarkably soporific. I could sleep through almost all of it. But I understand that some time ago the IRS was asked to format some of the regulations in a question and answer format. I tried reading those back a bit and found them—that's real obscure.

I want to know how many of these regulations the IRS has identified for elimination or reinvention.

Commissioner RICHARDSON. As of the current time, I think we have 30 regulations that we have identified, and we've put those out for comment. We are always on the look-out and if anyone

would like to identify others for us, we're more than happy to do that, as well.

One thing we have done, though, Mrs. Kelly, that I didn't mention earlier—I think it's in my written testimony—in response to concerns raised by small business people, particularly those who may not want to seek professional tax preparation help, we have and should have on the Internet in our FedWorld address I think within the next 2 weeks plain English summaries of new regulations, so that they will explain what they're about, who they impact, and if you want further information or need further information, can pursue getting into them in more detail.

But at least our efforts are being made to have straightforward, plain English summaries written by nontechnical people for non-technical people.

Mrs. KELLY. Those 30 are all question and answer?

Commissioner RICHARDSON. No, the 30 regulations that are becoming obsolete?

Mrs. KELLY. Yes.

Commissioner RICHARDSON. I'll have to get back to you.

Mrs. KELLY. So, you're not telling me an exact number of the question and answer format.

Commissioner RICHARDSON. No, I'm sorry, no.

Mrs. KELLY. I just don't have it. Maybe somebody else up here does.

Commissioner RICHARDSON. We can find out for you.

Mrs. KELLY. A couple of other questions here. I want to come out in this hearing with my concern about the accent on computers. There are many of us who own home businesses, who do own computers, but there are many others who do not and will not have the capital to even capitalize that.

For those of us who are, many of us can't access a cable where we can do anything with any rapidity. Also, I don't know, with your STEP resource kit, how quickly, if we're sitting there in the middle of the night, we're going to get an answer to a question, because in the middle of the night is when a lot of us who own small businesses and home businesses—that's when we're working on this kind of a thing.

Are you setting up any kind of a center for that?

Commissioner RICHARDSON. Well, to be very honest, until we know what our appropriation looks like for next year, and it doesn't look too great at this point, many of our plans are on hold. I don't know that we have plans for a center per se, as you've described it, but we would like to find ways to expand telephone answering hours—telephone information.

I'd invite your suggestions and those of your colleagues, as well as mine here at the table as to what we can do to make more information available, particularly to businesses that may not have access to technology or to computers. We are certainly very, very receptive.

Mrs. KELLY. I'd like to see you simplify it in a way where we could perhaps have a dialogue with a fax machine, somebody at one end and us at the other.

Commissioner RICHARDSON. I'm sorry. We are doing more with fax machines, and that is certainly a possibility we're looking into.

I can have Barbara Jenkins follow up with you and your staff on that.

Mrs. KELLY. I understand there's a lot of taxes out there that could be collected, so maybe you can go out and get some of those taxes to replace any monies that aren't coming through the budget so that we can have access to real people.

The other thing is I understand that there's about 500 regulation projects open at this time that have been open for a year or more. That's a big backlog, and I wonder how long you anticipate it's going to take for the IRS to complete the elimination or the reinvention of the regulations that were identified as part of that March 4 memorandum that you circulated.

Commissioner RICHARDSON. I'm told, and we will verify this with a more specific number, that we have just closed 200 or 300 of those projects.

Mrs. KELLY. So, you're down to 200 or 300 left.

Commissioner RICHARDSON. Right. I will get you the specific information.

Mrs. KELLY. Do you have a time line on that?

Commissioner RICHARDSON. The regulations are actually a joint effort between us and Treasury and I'll have to get back to you and your office with the specifics about how many have been closed and what our time line is. I don't have it in my head. I apologize.

Mrs. KELLY. Thank you. Madam Chairman, thank you.

Mr. WOLFE. May I comment, Madam Chair?

Mrs. Kelly, just to put it in the proper perspective, one of the roles that we feel we fulfill as tax preparers is to be the place where you go to get the plain English, common sense interpretation of what are they trying to do.

I can't emphasize enough the panic on the other end of the phone when a client, on Friday, has gotten a notice and it's Monday morning and they haven't talked to me yet. They are very, very upset. My job is to calm them down and assure them that we can resolve this matter in 6 or 8 months to their satisfaction.

That's the reason why the tax payer, or tax preparers, such as myself, are out there, because there's a need. If we could move the regulations and move the IRS a little more user-friendly, yes, I could do some other stuff; in fact, help those people make more money so we would, in fact, pay more taxes. That's what we'd like to do.

Mrs. KELLY. Mr. Wolfe, I appreciate your remarks. I want to say that I think you and I are totally allied in allowing you to have some time to even have some family friendly time around tax filing time. I think actually Miss Richardson is also headed in that direction. I thank you all.

Chairwoman MEYERS. Thank you. I think in order of appearance at the Committee meeting, Mr. Luther is next.

Mr. LUTHER. No questions.

Chairwoman MEYERS. All right. Mr. Flake.

Mr. FLAKE. Thank you very much, Madam Chair.

One issue that has been before this Committee in a hearing recently which the proposed changes seek to resolve is the one of small businesses where they are sole proprietors or individuals who are in business that are beneficiaries as it relates to estate taxes

who have had to go through a myriad of what I'd call hoops as it relates to trying to get the best possible resolution for the maintenance of the business beyond the death of that individual or beyond the death of those individuals who have started it, kept it going and all of a sudden come to the point where it appears that the beneficiaries will not be able to maintain it, largely because of the tax burden.

One of the propositions I've seen suggests that the 1.5 percent of the first \$1.5 million—million dollar, not billion; this is small businesses—that it would not be taxed 100 percent, and then \$3.5 million, only 50 percent taxation.

I'd like to invite any of your comments as it relates to what do you see as the impact of the change? Will this do enough? Will this allow those businesses to be able to be sustained beyond the death of perhaps the individual who started it them and have kept them functioning until the point of their death?

**Mr. FISHER.** I would respond on behalf of the National Restaurant Association that we would be very supportive of those changes which you have just mentioned.

**Mr. FARIS.** I'll tell you, from a small business NFIB perspective, our number one goal for the next 15 months is to repeal the death tax that's killing the family small business, farm, and ranch. It is the most unfair tax in America, is the death tax.

What's been changed is good but again, every time you make a change and it's a percentage here and a percentage there, we further complicate things. Why don't we just put it to rest so that we can pass along the family farm, ranch and business? We think that's critically important and I appreciate your bringing it up. It needs to be bipartisan because it's a bipartisan problem.

It's not, for the small business, that we're not talking about major dollars in the Treasury. We find a number of places that we would just love to swap out to have that happen.

So, I appreciate you bringing it up. We need to eliminate it totally.

**Mr. THAYER.** Mr. Flake, I would simply add to that that at the recent White House Conference on Small Business, the estate tax was indeed among those top tax issues that were discussed. I can tell you that the NASE, in polling our members, we find it in the top three.

So, certainly I think you're right on in your approach of saying that we need to do something about it and all of us here would simply say to you we want to see it happen because I think we're all in one accord.

**Chairwoman MEYERS.** I think it was number four, Mr. Thayer.

**Mr. THAYER.** That's right. It was number four.

**Mr. FLAKE.** Mr. Wolfe?

**Mr. WOLFE.** My comment would be, just to give you a little different perspective, if you think of small business in relationship to big business, the small business transfer or the small business sale is, in fact, the retirement plan for most small business families. That's either passed on or liquidated. The tax structure, the effective tax structure on that for small business, compared to a corporate executive that retires with a corporate plan, is significantly different.

By making these changes, by eliminating, by moving the standards up to 1.5 or 3.4, all that does is makes the playing field a bit more level as it relates between big corporations and small business—the owner and the family and the ability to pass that on and maintain jobs and grow jobs and grow that business into the future. I would support that.

Mr. FLAKE. You're suggesting that there are some other issues also in terms of the ability to develop proper pension programs and proper retirement programs that are not penalized as drastically as they are, particularly in the self-employment category and in the small business category. Am I hearing that?

Mr. WOLFE. Yes. If you just take the view that the business itself is the retirement and tax it appropriately as to retirement, that would be a benefit. Certainly I support elimination of estate and gift taxes on small business, the family ownership of businesses, but that's just a different perspective, an additional ammunition as to why it needs to be changed and why those estate taxes need to be eliminated.

Mr. FLAKE. Miss Richardson, has the department taken a position, the Internal Revenue Service, regarding this?

Commissioner RICHARDSON. Mr. Flake, we really are charged with administering the law once it's passed, so we're not in a position to take a position on this particular provision.

Mr. FLAKE. I'm certain you do get a lot of concerns raised in this area. It comes to us with some degree of frequency, so I would suppose that the Service itself would be in a position the at least, though you don't take a position, you could speak on behalf of the number of cases that you have, and I'm sure there must be a myriad number.

Commissioner RICHARDSON. I'd be more than happy to consult with my folks and get back to you for the record. I'm not aware that the administration of the provisions is a major problem. I think the real issue that you're hearing, or at least I think I'm hearing from colleagues on the panel, has to do more with whether or not these are good economic decisions and that kind of thing.

But as far as the actual implementation or administration, I'm not aware that there are any unusual problems.

Chairwoman MEYERS. Would the gentleman yield?

Mr. FLAKE. Yes, I would.

Chairwoman MEYERS. It probably is not fair to ask if you, as an agency or an individual, have a position, but do you know if the administration has a position on estate tax reform?

Commissioner RICHARDSON. I have to apologize. I'm not sure on this particular provision but we'll get back to you. I thought one of my colleagues from Treasury was here, but we'll get back to you.

Mr. FARIS. Madam Chair, we'll know fairly soon if the Finance Bill passes. It has a simplified pension plan in it. It has an inheritance revision, to increase inheritance levels that's in that bill. If, in fact, it comes to conference, it comes out, it's in conference and it goes to the President's desk, then we'll know. We'd like to know now because I've got to believe that President Clinton, from Arkansas, and his constituency from many years ago as governor, knows how important it is, in Hope, Arkansas, to keep the family farm, ranch and business.

So, our hope is that this President will join you and lead the charge and let's get this done. This is not complicated. This is real easy to be done. It doesn't take any code books. It just says, "Don't have it anymore. It's over."

Mr. FLAKE. Nothing's that simple here. It would be nice if it were.

Commissioner RICHARDSON. We do, however, support simplified pensions for small business, as you know, and have sent a bill up here.

Mr. FLAKE. That's great. Thank you very much. I yield back, Madam Chair. Thank you.

Chairwoman MEYERS. Thank you. I know that the gentleman will remember, too, that at the beginning of the year we had hearings on all proposed tax changes and the four that emerged as very important to small business were the home office deduction, expensing, estate tax reform, and capital gains.

Now, they all generated a lot of interest and enthusiasm on behalf of the small business community, but none generated the passion that the estate tax reform did. I think that it was a very, very strong feeling.

Mr. Longley.

Mr. LONGLEY. Thank you, Madam Chairwoman.

First, a quick question. How long, going back to the expense receipt requirement, how long is someone required to keep those receipts?

Commissioner RICHARDSON. Typically you're required to keep the documentation for anything you claim on a return for the years your returns are open, and there's generally a 3-year statute of limitations.

Mr. LONGLEY. I just wanted to point that out and I'm sorry that the gentleman from New York, in his earlier question, in my opinion attempted to contrast the private sector unfavorably with the IRS, but I don't think business has any similar requirement.

I think the clear issue, from my standpoint, in terms of my own experience in the private sector, is the burden of having to maintain all of these slips of paper for a 3-year period of time, not the fact that somebody provides adequate documentation at the time that they incur an expense. I thought that someone that appears to have such strong support for small business would want to see that point made.

Nevertheless, one of the things that comes through in your testimony, ma'am, is the fact that you're gearing a tremendous amount of resources to deal with the fact that small business does not have the resources to deal with the pages that we're looking at over on the table to my left.

I note that you have opened an IRS Office of Small Business Affairs. How many people are in that office?

Commissioner RICHARDSON. I have one permanent person and I guess there are five—there are six altogether.

Mr. LONGLEY. I'm assuming that there's responsibility for interface with other small business offices throughout the Government?

Commissioner RICHARDSON. Absolutely, both throughout the Government and offices throughout the Internal Revenue Service, both here in the national office, as well as around the country.

Mr. LONGLEY. Now, the President has directed the page by page review of all the regulations. Could you tell me approximately how many people you have in the agency whose responsibility it is to go page by page through the thousands of pages—

Commissioner RICHARDSON. I'll have to submit that for the record. I'm not sure of the precise number who work on that particularly project.

Mr. LONGLEY. Again, I appreciate the amount of time that you've spent going out and meeting with the small business community and aggressively trying to elicit their concerns. I guess the point that I want to make is, and I'm going to ask maybe for comment at the end, but I really feel that there is a massive lack of perspective. I note your conclusion that we cannot expect small business owners to comply fully with their tax obligations unless they understand those obligations.

I'm an attorney. I've been in business. I've also been in the military. I look at the thousands of pages of regulations on that table and I will state flatly it is impossible for the average small business person to understand those regulations, no matter how much effort you put into it, and I think that it's time that this Congress come to grips with that fact.

I want to make another point related to that. I served in the military, most recently in northern Iraq during Desert Storm. In all my years in the military service, I have never, never been subjected to the degree of micromanagement or regulation that I experienced in the private sector, and I say that as one who voluntarily gave up his civil liberties to go into the military to serve his country and who has some experience as an officer dealing with the military system.

What I think we have done, and going back maybe to the days of World War II, where we've entered into a love affair with the military and adopted many of the military organizational techniques that we used during World War II and have brought them into the Government to the point where we literally have a Federal Government that's attempting to duplicate a military-style system of regulation over a private sector economy.

I want to come back because I do want to ask for a comment but there is information that I think we need to start putting on the table because, as one Member of this House, I think it's time that we started dealing with the fundamental fact that this Government has grown to the point where, if you will and maybe on a humorous note, when the phone company said that we need to reach out and touch somebody, I think the Congress, over the last 40 years, really took them seriously.

Because when we figure that 80 percent of our population, over 200 million people, are subjected to those thousands of pages of regulations, and when I go back to 1913, when the income tax was first adopted and it only applied to less than, I think, .5 percent of the population, it seems to me that we have come an awful long way in the wrong direction.

When you point out that three out of four individuals do not itemize their deductions and two out of three pay a flat tax at a 15 percent rate, I'm assuming that that 15 percent rate is in addition to the 7.65 percent rate that's paid for FICA by the employee

and the additional 7.65 percent that's paid for FICA by the employer, and that does not include the regulatory cost, the paperwork cost, the expenses that go in with that.

I've got to say that from my perspective, I wonder whether these people ought not to be paying anything at all, and that we need to get—not only am I trying to underscore the importance of our reconciliation vote tomorrow, where we're going to finally get this country on the track to a balanced budget, but I want to again put some perspective on the fact that we have got to get control of Federal spending because that is a symptom of the fact that the Government has become so desperate for revenues that it is reaching out into every minor facet of the economy to the point that frankly, I don't think the economy can adequately respond and, if you will, they're strangling under the burden.

Again, I don't know if you have a comment and I don't want to monopolize the time. I would like to know if the IRS has any statistics or charts that would break down by income level the amount of revenue collected from the bottom, \$1,000 or \$2,000 a year right up to the upper limits, so that we as a Congress can come to grips with what percentage of revenue is derived from what income levels in the population.

Commissioner RICHARDSON. We can provide that to you this afternoon.

Mr. LONGLEY. The second point, and maybe this is really my question and I apologize for drawing it out but I do feel it's an important point that needs to be made, is to what extent is the Service prepared to acknowledge that it has been handed a set of laws and forced to adopt regulations that are inconsistent with the ability of most of our citizens to comply, because that seems to me to be the fundamental problem we're trying to wrestle with.

Commissioner RICHARDSON. I'm not prepared to make that comment because I don't believe it. I think that the vast majority of American citizens do comply and they comply very well, so I'm not prepared to make that statement.

Mr. LONGLEY. I'm not suggesting that they're not attempting to comply but what I am suggesting is that we have literally created a situation where even your law-abiding, fully committed, dedicated citizen, because of the mass of thousands of pages of regulations, that any one of us could be found guilty of probably five variations, based on the regulations that have been adopted.

Commissioner RICHARDSON. I think that a lot of the pages are devoted to large corporations, not to individuals. Maybe small businesses would be affected by some of them, the depreciation capital gains provisions. Probably a significant part of the Code is because of the capital gains provisions that are there.

So, I think that many of the provisions that are in there are not applicable to the vast majority of individual Americans. They have wages subject to withholding and frequently have interest and dividend income, which is subject to information reporting, but that's the extent of what a large number of individuals have to deal with.

They are very compliant, probably at the 99 percent level, based on our numbers.

Mr. LONGLEY. Ma'am, with all due respect, and I'm looking at the STEPS resource kit in front of me that I understand is geared

to small business, if I have to look at that before I make a decision to create a small business, then my guess is a significant percentage of people are going to say, "To heck with you." That is what I'm convinced is happening in the economy.

To the extent that the Service is prepared to acknowledge the fact that the burden is now exceeding the ability of many people to comply, we would very much be interested in what thoughts we could gather, as a Congress, to address these issues.

I might add I've talked with many of your enforcement people and every one of them has agreed with what I've tried to say today. They are dealing firsthand with people who are really struggling, trying to stay on top of their legal obligations and who are doing so, very committed individuals with consciences that are worried about their obligations, who are scared and worried and frankly, under a tremendous amount of pressure.

But anyway, I look forward to that information. Thank you.

Chairwoman MEYERS. Thank you very much, Mr. Longley.

Mr. Bentzen.

Mr. BENTSEN. Thank you, Madam Chair.

Commissioner, your job is, probably about—I think maybe being commissioner of immigration may be a little bit more difficult.

Commissioner RICHARDSON. That's what I tell her.

Mr. BENTSEN. Certainly about as popular. I was not an attorney before I came here, although I was in the private sector and actually dealt a lot with Section 103 and a lot of work around the tax code, raising capital for tax-exempt entities, and so I'm familiar with it.

I might add I'm sorry that I didn't bring this with me. I have in my office a book that I've had since 1986 called the Blue Book, which is from the '86 code reform, that's actually put out by the Joint Tax Committee. It's about that thick and it has congressional explanation as to why something was done, what was supposedly done in the past and where they thought they were going, which probably ended up into that.

That would lead me to my first question, which is how many letter rulings did the IRS provide last year?

Commissioner RICHARDSON. I'll have to give you that for the record.

Mr. BENTSEN. Is it more than 1,000, do you think?

Commissioner RICHARDSON. I apologize. I don't know. They're issued by our chief counsel's office. I will get that information for you.

Mr. BENTSEN. Let me ask the panel, given the complexity of the Code, in particular the corporate side of the Code or defining what is income, not income, which I think is the bulk of this, why did that happen? How do you think that happened? Was that Members of Congress who decided that? I mean ultimately they vote on it but did they come up with it? Did they come up with things like 45B, which I was reading about from the Restaurant Association, which I would add—I'm sorry Miss Kelly's not here, but this almost put me to sleep, just reading this, but most tax law would.

I mean, where does that stuff come from? Does that come from the public? Does it come from outer space? Where does it come from?

Mr. FISHER. I think it comes from the business community, again speaking on behalf of the National Restaurant Association. We felt that in our industry in particular that Congress had passed some legislation that was very onerous and burdensome to us.

The income tax credit for the FICA taxes that have been paid on tips we believe was an attempt by the Congress to help the restaurant industry recover from what they had earlier done with the loss of the business meal deductibility.

So, now, moving back to that, Congress did very specifically state that any taxes paid would be subject to the income tax credit for the FICA. The Internal Revenue Service has basically refused to go along with congressional intent.

Mr. BENTSEN. I understand. My clock is ticking and I've got a bunch of questions.

Mr. FISHER. I understand.

Mr. BENTSEN. I guess my point is generally business or different interests come up and they have different things that they are interested in. Oil depletion allowance, which I think is a matter of national security—I just happen to be from Texas, coincidentally, but I think that ought to be in there.

So, this sort of does occur, not just by osmosis. I probably agree with you on this, and sometimes you get changes.

That leads me to Mr. Wolfe's statement, and I apologize for being late. Did I understand you to say that you do not like—and you're a practitioner—that you do not like the Treasury to have the ability to issue regulations that have the force of law? Because if we didn't have that, wouldn't we then have to wait for the Ways and Means Committee and the Finance Committee and the Congress to adopt a bill which would make corrections?

Congress does, I can attest to you from being in the private sector, Congress does make mistakes from time to time. I know it's hard to believe.

Mr. WOLFE. Your perception is correct. I am not in favor of that. Prior to this procedure, the method that was used is Congress actually wrote the law, they took the time to write the law and gave us committee reports and background and interpretations and legislative intent.

That then was available to the taxpayer, as well as to IRS. The Commissioner and the Secretary of Treasury issue their regulations. Each taxpayer is entitled to their interpretation, and we use the court system to referee that.

Now we don't have that. The ball is 60 or 80 percent in the IRS's court.

Mr. BENTSEN. Don't we need the Service or the Treasury to be able—I mean, Congress does not always provide that detailed interpretation. In addition, I would argue from my own experience that tax lawyers will go and look at reports, they'll look at the committee reports to find the interpretation because every instance is different. Don't we need to have some flexibility where the Service and where Treasury can come in and make a regulation or provide a letter ruling subsequently to the act taking place?

Let me give you an example. There were many technical corrections which were contained in the 1992 Reconciliation Act which President Bush vetoed after the election. The fact was that there

are still issues which are outstanding which have still not been acted on. They didn't end up in the '93 OBRA Act.

So, here we are, 3 years down the road, and still trying to work these out.

Granted, Treasury doesn't always act the way you want them to and they don't always get things done, but that's true everywhere. But don't we still need that flexibility?

Mr. WOLFE. Yes, there's some benefit there for obviously an agency of the Federal Government to prescribe their regulations and their interpretations, and let's keep this in perspective. What we're doing here is raising tax money.

So, the question is how much money are we trying to raise, and what method are we going to use to raise it. My position is that we can raise the \$1.1 trillion or the \$1.3 trillion without the Code and without the regulations, and there might be a better way to build that mousetrap, to raise the revenue to run the Federal Government.

So, I think my response to your question is yes, they're certainly entitled to their interpretation, and that is a benefit. If the regulations were more that these are safe harbor; if you do it like this, we won't have any problems, those kind of things, that would be more beneficial and more user-friendly as far as from the taxpayer's perspective.

Commissioner RICHARDSON. The one thing I would like to add is you put an emphasis on having regulations then going to court. We couldn't accommodate in the court system all the potential interpretations that people might come up with, and I think it's very important that we try to resolve disputes far short of litigation. We spend a lot of our time trying to find alternate ways to do that.

So, I think that when you can have clear regulations that have examples that cover situations and further guidance, like the private letter rulings, you can go a long way in avoiding having to resolve cases in court. It's far more cost effective.

Mr. FISHER. We would just like to see simpler tax law and avoid the court system, as well.

Commissioner RICHARDSON. I guess our position is, and in response to Mr. Longley, as well, we're really charged with administering the law, so we're not in a position to talk about the various policies that are out there. We have the law that is the here and now that we have to administer, and that's what we're trying to work with.

Mr. FARIS. Mr. Bentsen, your question is super because you're firing me up to go back to the Kemp Commission and push us toward being sure that what we come out with in January is a system of taxation that doesn't require a table to hold up all the books, much less all the evaluations.

If it's simple enough and clear enough and visible enough, the Congress should write it in detail enough so that when the IRS or whatever the alphabet soup is that's going to manage it has a very clear, precise way of doing it; therefore they won't need 100,000 employees.

I mean the very Code itself and the regulations that come with the Code, the interpretations, we keep changing, trying to make this suit fit that never fit when we put it on in the first place.

We're just saying take the coat off. Let's start over again with a new coat.

This meeting today, Madam Chair, is firing me up to go to the Kemp Commission and say we've got to get this so simple that we don't need a table to hold up the regulations.

Mr. BENTSEN. Well, Madam Chair, Mr. Faris fired me up with about 50 other questions which I'd like to ask but I don't want to encroach on Mr. Bartlett's time. I won't ask 50 more but I would ask if we could do a couple more questions after the panel is completed. I did have a couple of things I really felt I needed to ask.

Chairwoman MEYERS. Yes. I would ask at this time unanimous consent to keep the record open for those Members who did not get a chance to ask every question that they wanted to because I think there will be some submitted by Members, probably not only to Ms. Richardson but to the panelists.

Mr. Bartlett.

Mr. BARTLETT. Thank you very much. I would first like to apologize for the necessity of being late. I was in a Science Committee mark-up. I wish we didn't have to schedule two committees to run simultaneously but I had to be in the mark-up, and I want to thank Madam Chairman for calling this meeting.

Relative to the last part of the discussion, I think clearly the executive should be enforcing the law, not writing the law. I think that to many of us in the private community, the regulations of these executive agencies are really law. They have the force of law. And I agree totally with Mr. Wolfe that the Congress needs to write laws. Mr. Faris, the Congress needs to write laws simple enough that we don't need lawyers telling us what they mean after we've written them.

We don't need regulators taking a 10-page law and interpreting that in 100 pages of regulation. This is just silly.

I'm really happy to see Mr. Bennie Thayer here today. He was out at a small business forum in western Maryland just 2 days ago, right?

Mr. THAYER. That's right. Thank you so much.

Mr. BARTLETT. He was a great contributor there. The questions asked there and the concerns there were essentially those that are expressed here. Our people effectively represented when their representatives are saying the same kinds of things that the people are saying in these small business forums that we're holding.

Mr. Longley mentioned that very few were involved in 1913 when this amendment was made to the Constitution. I was reminded of an experience in my childhood—this was in the early 1930's—that my grandfather was a salesman, a traveling salesman. He made pretty good money and it was rumored around the community that he must be really quite wealthy because he even had to pay income tax. That's a reflection of—

Commissioner RICHARDSON. Some of my predecessors actually got letters from taxpayers begging to pay tax because it was a sign of success. I will also tell you that I have a copy of an editorial from a New York paper in 1914 calling for making the law much simpler. It was much too complicated.

So, in some ways—

Mr. FARIS. Things never change.

Commissioner RICHARDSON. That's right.

Mr. BARTLETT. I come from the private sector. We have always done our own taxes. We have our personal taxes. We have business taxes. We have landlord kinds of things, rentals, with all of the accounting that must go with those. We operate a farm and we have all of that kind of business thing.

Until I retired—we still have the farm and we still have the rentals, but until I retired, we ran a land development home-building company and we had all of the business forms to contend with there.

We itemize our exemptions. We give to charities and we itemize our exemptions. So, we've always made out our own taxes, filed our own tax forms. My wife does most of that. She would ask for my help and I would read the things and I would read them three or four times and finally we would figure out what it said.

When you put it into common, everyday English, it wasn't all that hard to understand.

My question is, is it necessary that these codes be written in such obtuse, lawyer legalese that you need an interpreter? When you put it down in everyday English, it's not all that tough to understand it but I'll tell you it's an exercise in—it's like taking an IQ test to try and figure out what you mean in these instructions.

Can't they be clearer? Is there some reason we can't use everyday English?

Commissioner RICHARDSON. We are working, in terms of the instructions and the publications that we put out, we're working assiduously to try to put them into plain English and make them understandable by the vast majority of the people.

When you're asked the question can the Code be put in less legalese, I think you have to ask the legislative draftsmen about that.

Mr. BARTLETT. I needed to distinguish the regulations from the Code. That brings me to my next question and my last question.

I wonder if the members of the panel, and just simple numbers will do, would indicate to us from your perception the problems that our people have with taxes—use a percentage like 9010 or 991 or 4060, whatever. Will those problems be corrected, can they be corrected only by the Congress or are they problems that have been generated by the IRS's interpretation and implementation of the laws which the Congress passes?

Where is the major problem that people have?

Your first number can be Congress, your second number the IRS. Let's see how much of that is our problem and how much of it, in your perception, is a problem with the IRS. Start with Mr. Thayer and go that direction.

Mr. THAYER. Thank you very much, Congressman Bartlett. Certainly starting with Congress, you've heard it over and over again. We would love to see it simplified, just period—the legislation. As the Commissioner said in many instances, they don't write the law.

So, starting with Congress, we would like to see a more simplified tax structure, period. I think that message has been heard very clearly from Americans.

Certainly within the NASE, in our surveys of our membership, it comes back time and time again always up around 70 and 75 percent, we want simplification of the tax structure, all right?

Now, in terms of IRS, as you heard just in your district the other day, it has to do with much more than just the regulations that come out of IRS. We've heard here today that they have fewer than most agencies.

It has to do with the tenor of the relationship between the IRS and indeed the taxpayers. We think and we feel very strongly within the NASE, and I think we've heard here today, that that needs to be worked upon foremost.

Now, this Commissioner, and I think we've been on her quite a bit today and, Madam Chair, she didn't need the hard hat because it really wasn't directed at her—she truly walked into the White House Conference on Small Business and fielded the questions. Many of us did not believe she would come, and she did. She did that and she went from there to make some changes, one of which was obviously in response to the meals deduction, the \$25 to \$75. We appreciate that.

But what I'm saying to her here today and in conclusion is that somehow the IRS has to get a grasp on how we offer the customer service. How do we deal with Americans to change the perception that we're not always adversarial, that we're not always their enemy? That really is the problem. Most people will tell you the IRS is the enemy.

**Mr. BARTLETT.** Are we about equally responsible for the assault? About 50–50?

**Mr. THAYER.** If I had to put it, I would have to put it 50–50 at this point. That would be where I'd put it.

**Mr. FISHER.** I'll echo 50–50. I'll go 30 percent Congress and 70 percent the IRS, with one caveat. The 30 percent is really the ambiguity that comes from the legislation and the 70 percent comes from the regulations that are written and the interpretations, then we think the contravention of congressional intent.

Final comment would be 100 percent of the responsibility lies with the Congress for tax reform.

**Mr. FARIS.** When it comes to the Congress, the problem is the word trust, that the laws passed will be fair and consistent and stable and understandable. When it comes to IRS, the word is fear.

So, trust is tough but fear is worse. Any reporter who's ever done an article about IRS abuse cannot find small business owners who will let themselves be on camera to tell their story. They come to us and ask for examples and we can't give them.

The reason is a person was short 50 cents on their income tax and they had to pay \$70.29 for the 50 cents they were off. That not only makes them mad; they fear saying or doing anything for fear that they'll get on some sort of list with the IRS and these boogie people off somewhere are going to come in and do terrible things to them.

It's perception but it's real. It's fear and we need to eliminate fear by creating trust with the Congress to pass a very simple tax bill that does away with all this so that once again we don't have to fear our Government, who we're paying to serve us.

Mr. WOLFE. Mr. Bartlett, I've got it broken down 70-30, 70 percent Congress, 30 percent IRS. The reason I'm a little bit different perhaps than the others is because I believe, as you stated, it is the province of the legislative branch to legislate, and that's what we're talking about here. Right now we're paying in—taxpayers are paying, in the system that we have now, \$1.5 trillion, \$1.6 trillion. The question that I hear from taxpayers is one, how much should we be paying? What is a fair amount to be paying? And then second, what's my pro rata share of that?

So, if you approach it from that side, saying, "Well, how much money does it take to run the Federal Government? What programs and services are we going to provide to our people? What's the price tag on that?" Then you go and look and say, "Then what system can we put in place to raise that money?"

I hesitated because we have a policy in my office that if you use "fair" and "taxes" in the same paragraph, you have to leave the building, and I didn't want to do that.

So, the IRS's 30 percent is they have to administer what's happened. Congress has taken the easy way out. They're letting IRS, in fact, write tax law via regulations, and I don't think that's right. I don't think that's the system we want.

Mr. BARTLETT. You can't fire the IRS. You can fire us.

Commissioner RICHARDSON. I think we say that somewhat jokingly but I remind our employees that we do need to treat people courteously and respectfully, professionally.

Mr. BARTLETT. You need to write that in big letters and fax it out to all of them.

Commissioner RICHARDSON. We do and we're constantly reminding people and we'll continue to do that. Maybe we need to do it more aggressively. Certainly I don't defend any rudeness or lack of courtesy or any efforts to instill fear in anybody. That's not our objective.

I will say that we do have, as I mentioned, 200 million customers. We have many interactions with people over the course of the year that are very pleasant, that are not intimidating, because I hear from them, as well, sometimes expressing surprise that it was a pleasant experience.

So, I think that we have to remember that service is in our name, it is important, and we need to constantly be working on it. But we do have a tough job and we're not giving our people the tools sometimes they need to do that job, and that can be a problem, as well.

We don't always have access to timely information because of the way the computer system is configured. Letters cross in the mail. Penalties are imposed that perhaps shouldn't be, and you can't always configure the system exactly the way we'd like to do. In the next couple of years, when we have the new system in place, it will alleviate a lot of those problems that crop up today.

I do want to make sure that Mr. Faris and everyone here understands that if someone has a problem, they should feel more than free to speak up or to contact me. We keep no lists. We have not done that. We never did. There were those that were accused of doing that many years ago, and it is absolutely verboten in my agency.

So, I hope no one would ever be concerned about speaking up because we do not seek to have retribution and we cannot correct problems if we don't know what the problems are. So, if people don't tell us about them and if they don't let me know, I can't do much about correcting them.

So, I do invite you, your staffs and all of your membership to let us know about the things that you feel we could be doing.

Chairwoman MEYERS. Thank you very much.

Mr. BARTLETT. Madam Chairman, to show you how pervasive this is, and I'm through, when I ran for the Congress my wife told me I shouldn't do it because the IRS was controlled by a Democrat administration and I'd pay for it if I ran for Congress. So, that's how widely this thing is perceived. Thank you.

Commissioner RICHARDSON. The tax collector, back in history, has not been the most popular soul.

Chairwoman MEYERS. Let me get some dialogue between Mr. Fisher and Miss Richardson, if I can, on one subject. In your testimony, Miss Richardson, you referred to the TRAC initiative and the tip rate alternative commitment and I understand that you have reached agreement on that issue. But it sounds as if Mr. Fisher of the Restaurant Association is suggesting that more work certainly needs to be done with what the restaurant people recommended at the SBA-OIRA-sponsored forum with the IRS and that there has not been a response to this.

I'd like to ask Mr. Fisher to clarify what I've said, if I've misinterpreted, and I'd like your response.

Mr. FISHER. I would clarify one thing. Perhaps there's a misinterpretation. When the Commissioner states that there is a TRAC agreement, there is, but there's not an agreement necessarily between the National Restaurant Association and the Internal Revenue Service.

We take no position on whether any employer should sign the TRAC agreement. That's a business decision. We can simply inform them as to what it is about, how it works, educate them, and then they have to decide as to whether they would want to proceed with it, therefore sign it and abide by it, or whether they don't need to sign it. It is a voluntary agreement, by the way, and that's a business decision, so we take no position.

The difficulty that we have is that for us, the statutory language was very clear. It says for all taxes paid. We're really talking about two things here: The tips that are reported by employees and the unreported tips, because it's a fact of life, and we don't condone it and we encourage our employers to inform their employees about proper tip reporting and to pay their fair share of taxes because it hurts all of us when it doesn't happen that way. But there are unreported tips.

The Service has taken the position that the unreported tips would not be allowed to be taken as the income tax credit for FICA when that time comes. The next issue is the date at which it becomes—when the taxes are paid. So, whether they were unreported tips prior to December 31, 1993 or January 1, 1994, they won't allow that to come forward, either.

So, again, we've mentioned insensitivity. We've mentioned perception here. It just seems to us that there was a subversion. I

don't mean to be particularly harsh with that word but we had over 100 congressmen sign the letter, including the authors of the legislation that went into effect and said, "This was our intent."

Now, that went to the IRS and they have moved off of what the law says.

Chairwoman MEYERS. Could you respond to that?

Commissioner RICHARDSON. I'd be pleased to. I was not aware until I got a copy of Mr. Fisher's testimony late last night that he had these concerns about the credit or that he felt we had not been responsive to that forum. I'd be more than happy—I have Mr. Washburn here—to offer to meet with Mr. Fisher, and any others who'd be appropriate to talk to about the credit.

I know that you mentioned and I am aware that there's a provision in the House bill which may address your issue and solve the problem.

But in any event, we'd be more than happy to meet.

Mr. FISHER. That's the 30 percent Congress that I was talking about. There is that House bill.

Commissioner RICHARDSON. We'd be happy to sit down and talk to them about it. As I say, I wasn't aware that he had these concerns until late last night. The chief counsel lawyers who have been working on the project were not available to get into great detail at the time, but we'll meet with you next week, if you'd like.

Chairwoman MEYERS. Well, I hope this Committee has served a purpose here then today in maybe making you aware of a concern, that maybe it can be resolved.

Mr. Bentsen, you had one last question.

Mr. BENTSEN. Thank you, Madam Chair. Let me, in preface, say part of our problem of why—I think—why it's so complex is, and the practitioner can tell us, is the definition of income. I believe as long as—regardless of what Congress does, and we could have a one rate flat tax for corporate and personal income, we could call corporate and personal income the same thing, you're always going to have people who are going to have to—you will be doing this probably—figuring out, well, what exactly is income and what's not.

You look at what you're talking about with regard to cash or accrual accounting affects income. You look at how you treat someone as an independent contractor or an employee has to do with income.

So, there's always going to be that problem.

Congress is probably 90 percent responsible for this because we do write the laws. But the fact still remains that somebody is going to want to interpret it and there's always going to be somebody with a special exception that they want to have considered.

Let me ask two things. One is on the estate tax, do you believe, Mr. Faris, that we should do away with the estate tax as it relates to all entities? Let me give you an example. We talk about family farms and ranches and things like that, and I agree with you on that. Should we treat it the same for a 1,000-acre ranch in Victoria versus the King Ranch, which runs 40 miles through south Texas?

Mr. FARIS. Well, if somebody has a 1,000-acre ranch in Victoria and you did away with the death tax, you'd have to put them in the Detar Hospital in Victoria because their heart would be jump-

ing right out of their body, they would be so surprised and shocked and pleased.

The King Ranch in Texas, what we've found is that the King Ranch and the Rockefeller family and all the other specific examples we have of family wealth that's passed along and stays in the family, those are very much the exceptions. My guess is they have enough accountants and attorneys to figure out how they don't have to pay it anyway. They get around it through trusts.

Who's really suffering with the inheritance tax? Let's not make it complicated. Let's just do away with it.

Mr. BENTSEN. I mean altogether, but then you would do it with the King Ranch. Sure, they probably set up limited partnerships and things like that.

Mr. FARIS. They're probably not going to pay it anyway.

Mr. BENTSEN. Well, they probably still pay some tax but they may pay less. But you would just do away with it completely.

Mr. FARIS. Yes, sir.

Mr. BENTSEN. Let me ask you this. On tax reform, and there basically are two big proposals that are out there. One is some form of flat tax, which is still an income-based tax, and the other is a consumption tax.

With respect to a consumption tax, how do your—and I'd ask the Commissioner, too, but among the groups that are represented here, how do your members feel? Let's say everything is off the table. Nobody gets a special exemption. Nothing for the realtors. Nothing for the auto dealers. Nothing for any one, so that you go to a 17 or 20 percent VAT or some form of consumption tax.

Who becomes the tax collector in that process? And is there a concern about that?

Then I would ask the Commissioner, in your opinion, both as Commissioner and in your prior life, is it fair to say that the IRS will go away? Will there be a three-person office over at Treasury who will make sure that the Texas State Comptroller, who is a very good person, is making sure all the collections are there? Is there a problem that there's no uniformity between Texas and Oregon and New York, et cetera?

Mr. FARIS. My members feel that, not about any individuals, but our members feel that IRS is a four-letter word, and that's bad to start with.

So, first of all, if you make sure that whatever you have in taxes is very simple for me to understand, that everybody has some skin in the game. Now, we want people to be able to eat first, but everybody should pay tax. No loopholes for anybody. Everybody pays. It's done on the same kind of basis and it's very visible and it's extremely difficult to change, so we can have confidence.

Our members are telling us they're ready for looking at a number of different kinds of systems if, in fact, those principles will hold true.

I'll not answer for the Commissioner but our members know that as long as there's a Federal Government, there will be taxes collected; there will be employees needed. But we feel like that if quite a few thousand IRS people could possibly have an opportunity in the free market economy to fill some of the jobs that need to be filled, because with a simpler system of taxes our economy

would be growing at the rate that we'd be short of people, and we'll need all the IRS sharp people who are sitting in this room today to be in business.

Mr. BENTSEN. To define what income is probably. But nonetheless, would that mean that—is there going to be a pledge of some sort that all the lawyers who aren't busy interpreting what the regulations are aren't going to be standing outside the Ways and Means Committee room when the bill's being written saying, "Well, that's great except for I need this little sort of adjustment here and this little transition rule over here."

Mr. FARIS. Congress, two-thirds of the people who are in this town don't have to be here because they won't have a reason to be here because they won't have any niche to protect and they can be home making money, real money, outside the Beltway that provides revenue so that the rates won't have to be as high, no matter how you define the income.

We've got to focus on productivity. We've got to focus on free enterprise and job encouragement, and not have to take so much of our time trying to focus on regulators and all the complexities of the Code and the regulations.

So, we're looking forward to a new tax system, but with some trepidation because so far, every time we've had something simpler, the forms got longer to explain it and we had to hire more people to advise on Government instead of Mr. Wolfe advising us on how we can make more money in our business. We'd like to write him a bigger check maybe.

Mr. BENTSEN. Well, you always want to hold your vendors down as much as possible.

Mr. FARIS. Of course.

Mr. THAYER. Congressman, if I might, our members—we've polled them continuously on this subject—flat tax, consumption tax. We have yet to get a definable or definitive answer in terms of which one they prefer. It's kind of like Mr. Faris has alluded to. It comes down to simplification. They want a simple system.

I think more importantly, they want what he has raised: An equitable system. Everybody pays, small guys, and our members tend to be those smaller members. Don't put the bulk of the onus upon our backs, OK? Make it equitable. Everybody pays into it.

Then finally, whatever system, if you're going to put in any incentives, let them be incentives that would grow the business, that would cause us to be more productive in terms of operating our business. The incentive might be simply to, as they put it very candidly, get off our backs and let us do what we do best in the business or the service.

Mr. BENTSEN. In the everybody pays that both of you talked about, is it fair to say that there's a contradiction in the tax plan that repeals the corporate AMT?

Mr. FARIS. Well first of all, businesses don't pay tax in the first place. We collect them but we really don't pay them. AMT you figure you have to, whether you owe it or not, you still have to go through the process of figuring it because another tax now is based on that. Now the EPA wants to know somebody and it's based on how you figured that.

So, it becomes more convoluted. But if what you're suggesting is—

Mr. BENTSEN. If you're a—

Mr. FARIS. Excuse me.

Mr. BENTSEN. I was going to say if you're a capital-intensive corporation and you don't necessarily match depreciation—you can match depreciation schedules, then you may not pay any tax. I appreciate the fact that maybe you don't pay taxes; those are passed on. But doesn't it still, by eliminating the corporate AMT, wouldn't that allow some corporate entities not to pay tax, whereas others will?

Forgetting the question of passing on tax—that's another economic issue—but is that equitable, if you're a non-capital-intensive company versus a capital-intensive company?

Mr. FARIS. Well, since most of our members are not capital-intensive in terms of our definition of capital is labor capital, we don't like having disparity. But, at the same time this whole subject really chokes me up.

At the same time, what we go through across the board to try to solve one or two exceptions is ridiculous. We'd rather have the exceptions, again, if we handle things straight, cash flow, and we didn't choke to death.

Mr. BARTLETT [PRESIDING]. I'd like to thank the members up here and the members of the panel. You've broached a subject that I'm very much interested in and I want to thank you all very much for coming, for the good questions from here.

I just want to ask one last thing and just a word or two is enough. We're very early in the dialogue on changing the tax structure. We're talking, on the one hand, about a flat tax, on the other hand about a consumption tax. If we go to a consumption tax, I'm totally opposed to a VAT tax. Hidden taxes are the worst kind of taxes. You're had and you don't even know it. I want it visible.

Where are you? What are you leaning toward? What are your people leaning toward at this time? Could you just go down the line, starting with Mr. Thayer. You said it's roughly 50-50?

Mr. THAYER. They're not leaning to either the flat tax or the consumption tax. What they're talking about are certain parameters that must be included.

Mr. BARTLETT. Do they have some characteristics they want any tax to have?

Mr. FISHER. Most are telling us flat tax but with some trepidation because they say how flat is flat, because of the exemptions that could possibly come in. The consumption tax is not a good idea because too much of it would still escape to the underground economy.

They are very much against a value-added tax for all of the reasons that I think you're well familiar with. If the flat tax got to be too high, some of our people are saying the graduated income tax currently is not all that bad.

Commissioner RICHARDSON. I don't know that I'm speaking for my people but I can certainly speak for myself and that is, in response to something that Congressman Bentsen said, as well, I think that whatever system we have, we're going to be prepared to administer it and I think we will do a first-rate job.

I don't believe that you will do away with some entity to collect taxes. I recently met with some of my counterparts from other parts of the world and they said that if I was able to find a way to collect taxes without having a structure to do it, that I would have lifetime employment, because every other Government in the world would be very interested in how they could emulate it.

They did express a lot of surprise that we are spending so much time trying to throw away a system that has served us very well in this country in many ways. They do understand the need to make things perhaps simpler and maybe even provide some economic growth incentives.

But when you look at other systems in the world, and I've just heard that I don't think there is a consensus about whether it should be an income tax, a value-added tax, a sales tax. Until we have some consensus about what our goals are, what kind of tax we have, I'd say that perhaps the devil we know is better than the one that we don't. I think before we throw out what we have, we should be very careful about what we plan to replace it with.

Mr. BARTLETT. Mr. Archer obviously supports the consumption tax and one of the reasons he says is that we wouldn't need the IRS, which we would need in a lesser form for the flat tax. He says the IRS is an evil weed; if you leave its roots in the ground, it will grow again.

You don't think most Americans believe that?

Commissioner RICHARDSON. I don't believe that most people believe that and I believe that maybe even Mr. Archer doesn't believe that.

Mr. BARTLETT. Two more, real quickly.

Mr. FARIS. If we do away with the IRS employees, we'll create other employees with a different alphabet to identify them, but there will be employees in the Government who collect the taxes that have to be collected and to make sure they're being paid fairly.

But if you have a system that's so open and that is simple to figure out, it won't take nearly as many employees, and maybe one of the reasons sometimes the employees aren't really nice is that not many people call them and say, "Oh, how are you today at the IRS? Do you have a few minutes for us to chat?"

Now, probably, by the time they get on the telephone, they'd be like me the other day. When I finally got the recording machine after four telephone—punch 3, punch 7—I had to make notes and call back again. But I finally got through and when I did I'm sure I came across on that recording machine like I don't want to call him back, you know.

So, if we can have something very simple, then we don't have all that frustration to deal with.

Mr. BARTLETT. So, which of these is simpler? Flat or consumption?

Mr. FARIS. Our members have said until we know more of the detail, the devil is in the detail and therefore when we know more of the detail, then we're going to be ready to choose. Right now we know we don't want the VAT tax and we know what we've got needs to change.

Mr. BARTLETT. Last?

Mr. WOLFE. In my opinion, it's a two-step process. Step one is go to flat tax. Step two is use the talents of Congress to arrive at whatever is appropriate.

Mr. BARTLETT. Thank you. We're very early in this dialogue. We'll continue, I hope not forever but for a couple of years until we have really a consensus of the American people. Thank you all very much for your testimony.

[Whereupon, at 1 p.m., the Committee was adjourned, subject to the call of the chair.]

## A P P E N D I X

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### STATEMENT OF FLOYD H. FLAKE BEFORE THE HOUSE COMMITTEE ON SMALL BUSINESS OCTOBER 25, 1995\*

I thank you, Chairwoman Meyers for convening this hearing examining how the IRS' efforts to reduce regulatory and paperwork burdens on small business. I also commend you and your staff for reexamining many of the suggestions made by small business owners during the White House Conference on Small Business. In our continuing efforts to insure that federal agencies are operating in a streamlined, cost-effective and customer responsive manner, it is important to conduct periodic checks on changes toward this end. In this hearing, we have the unique opportunity to review how the IRS' proposed regulatory reform will ultimately benefit small businesses. I was proud to learn that, as a result of the suggestions made in Vice President Gore's Report, the IRS, Social Security Administration and the Department of Labor jointly developed a Simplified Tax and Wage Reporting System. I also would like to commend the IRS for instituting the Office of Small Business Affairs which provides a vehicle for small businesses to recommend changes to IRS practices that unduly burdensome. While regulation, compliance and standards are necessary to promote standard business practices, we have to shape such policies to support small business and to insure that each worker receives equal and just tax treatment. By examining tax policy within worker classification areas, requiring detailed cost-benefit analyses of proposed regulations and encouraging small business participation in tax policymaking, we can create a tax system that will reduce regulatory burdens which stifle small business. Ultimately, we must demand that tax regulations do not inhibit the businesses that we deem as the engines of a strong economy. So, with that said, I hope to gain a better understanding of how the Internal Revenue Service has addressed many of the small business issues which have surfaced in the Administration's Conference and in the agencies' interaction with small business owners.

STATEMENT OF REP. JOHN J. LaFALCE (D-NY)  
Ranking Minority Member, House Committee on Small Business

IRS INITIATIVES TO REDUCE REGULATORY BURDEN ON SMALL BUSINESS  
October 25, 1995

I am pleased that we have the opportunity today to focus on several key, tax-related issues which are of great concern to the small business community. I have been a long-time supporter of efforts to reduce regulatory and paperwork burden on small business and, in my view, relief in this area is long past due.

Last Congress I was an original co-sponsor of legislation to promote regulatory flexibility, as well as legislation to reduce the paperwork burden on small business. This year I voted in favor of the Paperwork Reduction Act which was signed by President Clinton and went into effect the first of this month. I also voted in favor of the House regulatory flexibility bill, H.R. 926, and am hopeful that differences in the Senate can be worked out so that this much needed legislation can be enacted.

The Administration has shown a particular sensitivity to the concerns of small business, and I commend President Clinton and Vice President Gore on their initiatives to "reinvent" government and make it more responsive to those it is intended to serve. The Clinton Administration has recognized the critical importance of reducing regulatory and paperwork burdens on small business and has taken significant steps to remedy the existing problems in a responsible manner.

Today I look forward to hearing from Commissioner Richardson

on the progress made by the IRS in complying with the Administration's initiatives. Of course, there are areas of concern regarding the IRS's efforts. While I suspect the IRS is aware of many of these concerns, I am confident that our distinguished panel of representatives from the small business community will bring to the attention of the IRS and this Committee concerns which they feel have not been and are not being addressed sufficiently.

As indicated by the delegates to the White House Conference on Small Business, tax-related regulatory burdens are some of the issues of greatest concern to American small business. It is my sincere hope that this hearing will be an opportunity for the Congress and Administration to continue to work together, listen to the small business community, and move forward with reasonable reductions in regulatory and paperwork burdens.

STATEMENT OF THE HONORABLE DONALD MANZULLO  
BEFORE THE HOUSE SMALL BUSINESS COMMITTEE  
OVERSIGHT HEARING ON  
THE INTERNAL REVENUE SERVICE

October 25, 1995 10:00 AM ROOM 2359 RHOB

Madam Chair, I applaud your efforts to continue to hold oversight hearings today on the Administration's and Congressional initiatives to reduce regulatory and paperwork burdens, this time focusing on the Internal Revenue Services (IRS).

Nothing strikes more fear into the hearts of Americans than the IRS. The IRS has immense authority to delve into the personal lives of countless Americans. With that authority comes great responsibility to exercise it with care.

That's why many of the top recommendations of the 1995 White House Conference on Small Business focuses on tax reform. In fact, four of the top ten recommendations emphasize some change in tax burdens on our nation's small businesses.

I support this committee's effort to devise a report card on how various agencies are complying with the President's directive from earlier this year to do away with outmoded or unneeded rules and reform the regulatory process.

In addition, I support the efforts in the House of Representatives to pass the Taxpayer's Bill of Rights. We need to further protect the taxpayer from unwanted abuses by the IRS.

Madam Chair, I look forward to the testimony of today's witnesses to provide the committee some insight as to the progress being made not just here in Washington but out in the field at the IRS. Thank you.

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**Congress of the United States**  
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**Washington, DC 20515-1316**

**Comments To The Congressman**

The following form has been provided for your comments, questions, or suggestions to Congressman Don Manzullo. The information you provide will allow your Congressman to best address the issues on behalf of the 16th District. All information appearing on this form will be submitted into the record of the House Small Business Committee.

Name: *TOM SEXTON*

Address: *DETROIT AUTOMOTIVE SUPPLY CO., INC.*

City: *DETROIT*

County: *DETROIT*

Zip Code:

Comments: PLEASE ACT FAVORABLY ON S. 545 WHENEVER POSSIBLE. This sales tax reform act is very important to helping to eliminate a tax collection loophole that now exists by law. I've talked to you about this a couple of years ago at MCC and other merchants in other businesses also agreed. It's a blatant unfairness that we "locals" are required to collect & pay the taxes, but the M-C firms don't! I also feel the \$3 MIL exemption if the \$545 is too high, and there are available softwares that can charge taxes based on ZIP codes. Of the estimated \$3BIL in evasion sales taxes yearly across nation, Ill is estimated at \$100 mil of it for its share. This is no small potatoes and is only fair and just!

*Thanks, Tom Sexton*

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**STATEMENT OF  
REP. JAN MEYERS (R-KANSAS)  
CHAIR  
COMMITTEE ON SMALL BUSINESS  
U.S. HOUSE OF REPRESENTATIVES**

**October 25, 1995**

**"The Internal Revenue Service's Initiatives  
to Reduce Regulatory and Paperwork Burdens  
on Small Business"**

**Good morning. Today the Small Business Committee will hold a hearing on "The Internal Revenue Service's Initiatives to Reduce Regulatory and Paperwork Burdens on Small Business".**

The IRS itself estimates that the American public expends over 5 billion hours in responding to the regulatory forms, reports, and recordkeeping requirements of the tax system. At \$50 an hour, that amounts to over 250 billion dollars of effort on the paperwork demands alone. Small business carries a disproportionate share of that burden.

In May, the President signed the Paperwork Reduction Act of 1995, legislation that passed this Congress unanimously and establishes a goal of reducing the Government's overall paperwork burden upon the public by 10 percent in each of upcoming two years. When you consider that the IRS share of that goal will be some 500 million hours, or 25 billion dollars, you get a picture of the enormity of today's subject matter.

I want to welcome Margaret Richardson, the Commissioner of the IRS, who will provide us a progress report on the IRS's efforts on this issue, and participate in this morning's panel with four leading voices from the small business community.

**Commissioner Richardson made a lasting impression at the**

White House Conference on Small Business this past June when she put on a "hard hat" in addressing conference delegates. We are glad you survived that experience Ms. Richardson. I want to thank you for your continued willingness to sit down with the small business community and members of this Committee to discuss efforts to reduce regulatory and paperwork burdens.

I also want to welcome our distinguished panel of small business witnesses. Jack Faris is a small businessman as well as the President of the National Federation of Independent Business. Ken Wolfe, who will be introduced by Jeff Joseph, Vice President for Domestic Policy of the U.S. Chamber, is a small businessman who hails from Kentucky and was a delegate to the White House Conference. Bill Fisher is the Executive Vice President of the National Restaurant Association. Bennie Thayer is the President of the National Association of Self Employed and also headed the Maryland delegation to the White House Conference.

At the White House Conference, the President committed his Administration to reducing significantly regulatory and paperwork burdens on small business. He highlighted his March 4, 1995 Memorandum to Department and Agency Heads on Regulatory Reinvention Initiatives. He directed that they make regulatory reform a priority, do a page by page review of all regulations, and report to him on which regulations would be eliminated, which needed Congressional attention, and which they planned to reinvent.

In July, this Committee began a series of oversight hearings to evaluate and develop a report card on these as well as other Congressional and Administration initiatives to reduce regulatory and paperwork burdens on small business. Sally Katzen, the Administrator of the White House Office of Information and Regulatory Affairs, and Joe Dear, the Assistant Secretary of the Occupational Safety and Health Administration, participated in

panels with small business representatives in two previous hearings. Today is our third such hearing. We plan next to invite the Administrator of the Environmental Protection Agency.

Oversight is not very exciting work. But as I have stated before, I believe a major mission of this Committee is to be a forum for the small business community. Small business is the lifeblood of America. There are enormous opportunities to eliminate the unnecessary costs of regulatory compliance we should tackle if we are to encourage and enhance the entrepreneurial spirit of small business.

My intention during these hearings is to continue the dialogue between the small business community, the Administration, and Congress on the work of eliminating wasteful regulatory and paperwork burdens on small business. I believe there is much common ground and common sense that can be pursued with this approach.

**Committee on Small Business  
The House of Representatives**

**Opening Remarks  
of  
The Honorable Glenn Poshard**

**October 25, 1995**

Thank you, Chairwoman Meyers, for holding today's hearing on the Internal Revenue Service's efforts to reduce the regulatory and paperwork burdens often placed upon many of our country's small businesses. I look forward to learning more about the Internal Revenue Service's continuing endeavor to respond to Congressional and Administration initiatives focusing upon regulatory reform. As an issue focused upon at the White House Conference on Small Business which convened earlier this year, I believe it is important this Committee ensure federal agencies continue to work toward this practical and sensible goal.

Thank you again, Madam Chairwoman, for holding this hearing. I would also like to thank the members of today's panel, especially Commissioner Richardson, for joining us today, and I look forward to each of your testimony.



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STATEMENT OF  
JACK FARIS  
PRESIDENT  
and  
CHIEF EXECUTIVE OFFICER  
NATIONAL FEDERATION OF INDEPENDENT BUSINESS (NFIB)

Subject: The Internal Revenue Service and Regulations  
Before: House Committee on Small Business  
Date: October 25, 1995

Statement of Jack Faris  
President  
National Federation of Independent Business

Madam Chairman, my name is Jack Faris and I am the President and Chief Executive Officer of the National Federation of Independent Business (NFIB). NFIB is the nation's largest small business advocacy organization, representing more than 600,000 small business owners in all 50 states and the District of Columbia. The typical NFIB member employs five people and grosses \$250,000 in annual sales. NFIB's membership mirrors the nation's industry breakdown with a majority of its members in the service and retail sectors.

I want to thank you Madam Chairman and the Committee for having me here today to discuss one of the greatest concerns of our membership: IRS regulatory and paperwork burdens on small business. But before I go into the horrors of regulation it is important for the Committee to understand the composition of the business community and some demographics of small business owners.

First, it is important to look at the business community as a whole. One inaccurate perception in this country is that all business is big business. This is not correct. There are five million employers in the United States today. Of those five million, 60 percent of them employ 4 employees or fewer and 94 percent employ fewer than 50 employees. These figures illustrate a fact that is typically lost during debates on the impact of certain legislation and regulations -- small business by pure volume dominates this country's economic engine.

Another misleading perception is that a small business is a smaller version of a big business. Nothing could be further from the truth. For example, one-half of small business owners start their business with less than \$20,000, most of which is from personal or family savings. Most small business owners do not make a lot of money (40 percent earn less than \$40,000); they survive on cash flow not profitability. Start-up small businesses are the most vulnerable. Of the 800,000 to 900,000 businesses that start each year, half will be out of business within five years. Many small business owners will tell you that the burden of regulation has much to do with whether they survive or perish. While it is rough going at the start, the small businesses that do make it are the major job generators in this country. From 1988 to 1990 small business with fewer than 20 employees accounted for 4.1 million net new jobs, while large firms with more than 500 employees lost 501,000 net jobs.

Many in Washington have noted the absence of a consensus on a great number of issues facing this country. There is growing bipartisan agreement about a phenomena that is taking place in America's small business sector -- the burden created by federal regulation falls predominantly and disproportionately on the very people who we rely upon to create jobs, small business owners.

### The Costs of Regulations

Small business owners across this country are being trampled by the costs and burdens associated with regulations. The evidence is abundant and also easily convincing. NFIB has gathered it from our own research, others in Washington researching this issue, and most importantly from individual members who are struggling to comply with the federal government's web of regulations.

When looking at the data it is easy to see why regulations are the fastest growing concern to small business owners. The dead-weight loss to society from regulation is estimated to be more than \$1 trillion dollars per year. By dead-weight I mean that the losses due to regulation exceed the benefits of the regulation by more than \$1 trillion per year.

According to studies done by Thomas Hopkins of the Rochester Institute of Technology, and William G. Laffer, III and Nancy Bord of the Heritage Foundation, the direct costs of regulatory compliance to businesses that are associated with regulatory compliance are somewhere in the range of \$500 billion to \$800 billion dollars. The current Administration pointed out in its National Performance Review that the compliance cost imposed by federal regulations on the private sector were at least \$430 billion per year or 9 percent of GDP.

Complying with regulations costs our economy dearly. The hidden tax of complying with regulation is no less a tax than any other government levy. And when it comes to businesses, this hidden tax is regressive; it hits the "little guy" the hardest.

There are several reasons why smaller businesses bear a heavier regulatory burden than larger businesses. One reason has to do with the fixed cost aspect of regulation. Almost all regulations have some fixed costs. Fixed costs are independent of output, i.e., any company affected by the regulation pays the same fixed cost. An example of fixed costs would be a requirement that every firm complete a lengthy quarterly report submission to a regulatory agency. It would cost every firm the same amount to complete the report. But larger firms can spread the fixed costs over large quantities of output. The average fixed cost or fixed cost per unit of output is low, therefore, and it has only a small effect on price. The smaller company with the same fixed cost, but lower levels of output, has a much higher fixed cost per unit of output. If the smaller firm passes the cost on to the consumer by raising prices, fewer will buy the product at the higher price and profits will fall.

This is a technical explanation, but simply put, small business because of economies of scale is not equipped to deal with federal regulations. Walk into any small business and look for the accounting department, the legal counsel, or the human resources division. You will not find them.

Unfortunately, the case I just made has rarely been understood by bureaucrats. The avalanche of regulation continues to pummel the small business owner. Case in point, there were 64,914 pages in the Federal Register in 1994, this is compared to 44,812 pages in 1986 -- an

increase of 20,102 pages. Just remember how small the print is on each page of the Federal Register and one can begin to conceptualize the burden of the regulatory avalanche.

#### A Small Business IRS Story

An active member of the NFIB told me about an experience he had some time ago with the IRS. He was new in the construction business, and having difficulty making ends meet, as so many new small business owners do. He had hired a number of employees but couldn't afford to pay all their payroll taxes. After a month or two of not paying the full payroll tax amount to the government he was paid a visit by an IRS agent. The IRS agent probably could have slapped a fine on this business owner right then and there, or initiated a civil action against the business owner, but he didn't. Instead he sat down with our member and said "you haven't been paying your payroll taxes." Our member said "I know, I haven't been able to afford it." And the agent said "here's what we're going to do -- Over the next two months, you are going to pay back the back taxes you owe, and keep up with the current taxes. Just to make sure that you're following this schedule I'm going to come into your business once a week to collect your payroll deposit." And our member repaid his taxes over that time. He was not fined or penalized. Today he has a thriving construction business with 250 employees, and he's had no trouble with the IRS since.

If the IRS had slapped a fine on this business owner it might have been enough to put him under for good. The point is that negotiation and flexibility from the IRS often can achieve far greater results for all involved than heavy handed enforcement tactics. This is a story with a happy ending; the trouble our members have with the IRS is that there are still far too many stories with unhappy endings, where IRS agents use heavy handed tactics in their enforcement approach when such tactics really are not necessary.

All too often, the stories we hear from our members are about small business owners being bullied by the IRS. Many of our members spend most of their time worrying about making payroll -- they do not have the time or the resources to hire a tax attorney and take on the vast resources of the IRS. We hear often from our members about IRS mistakes that have resulted in unwarranted penalties to the small business owner. The unfortunate reality in many of these cases is that it is easier to pay the fine and get rid of the problem.

The great inequity that exists between small business owners and the IRS and the unfairness that results is why the NFIB strongly supports the Amendments to the Taxpayer Bill of Rights, legislation which is currently included in both the House and Senate Reconciliation bills. This legislation would help level the playing field and reverse the assumption by the IRS that all small business owners are guilty until proven innocent. Specifically, it would shift the burden of proof from the taxpayer, where it exists under current law, to the IRS, to show the IRS was justified in its enforcement action against the taxpayer. If it is determined that the IRS was not justified, the taxpayer would be reimbursed for attorneys fees.

What can the IRS do to help alleviate its poor relationship with small business owners? What is really necessary is a complete change in attitude -- and a greater focus on education, simplification, and communication with small business owners.

#### **IRS Efforts To Reinvent Regulations**

We at NFIB do believe that progress has been made under Commissioner Richardson's tenure to change the attitude of the IRS toward small business owners in a positive way, and we commend her for her efforts. The initiatives that the Commissioner announced at the White House Conference on Small Business as part of the Administration's Regulatory Reinvention are a welcome step in the right direction. However, there remains much to be done. Our surveys show that IRS regulations continue to top the list of our members' greatest concerns.

It is of course true that much of what needs to be done the Commissioner cannot do herself. To truly change the IRS in a way that would satisfy our membership requires a complete statutory overhaul of the tax system. I am hopeful that we can achieve that goal someday in the not-to-distant future; and the pursuit of that goal is something in which I have spent a great deal of time lately, in my role on the 14 member National Commission on Economic Growth and Tax Reform.

Until we come to the day when we can eliminate the IRS as we now know it, however, we at NFIB will continue to push for legislative and administrative changes to reduce the overwhelming regulatory and paperwork burdens that the IRS places upon small business owners.

#### **Small Business Legislative Agenda**

Over the past six months, NFIB has been working hard to see that regulatory relief is being undertaken by Congress. In the first one hundred days NFIB members from across the country flooded members of Congress with pleas for reducing the government regulatory burden.

NFIB fully supported the regulatory reform proposals in the Contract With America and applauded the House for taking the first big step in easing regulations on small business.

For many years NFIB members had been calling for many of the legislative initiatives found in the Contract With America. No single issue exemplifies this more than reform of the Regulatory Flexibility Act.

The Small Business Regulatory Flexibility Act was enacted in 1980 to help ease the regressive impact of "one size fits all" regulations on small business. It was intended to force regulators to consider the differences between big and small businesses, to recognize the unique constraints placed on small business, and to reduce the burden on small businesses. Unfortunately, the Regulatory Flexibility Act doesn't work because there is no way to challenge the compliance of the regulators in court. Additionally, IRS regulators have consistently avoided the requirements under the Reg Flex Act by-classifying regulations as "interpretive" rather than rulemakings.

The House passed legislation that would solve these problems by instituting a judicial review component to the Reg-Flex Act. With judicial review regulators would have to think twice when they exploit loopholes in the Reg Flex Act because they could be taken to court for violating the intent of the law.

Another initiative passed in the first one hundred days was the Paperwork Reduction Act. Small Business owner for years have been asking for relief from the avalanche of paperwork imposed by government regulators. Although we were pleased to see this legislation signed into law by the President last May, we were disappointed to see that the final rule issued on August 29 contains a loophole that may allow the IRS to circumvent to requirements of the law.

We at NFIB applaud the House for the initiative it has shown to bring about regulatory relief for small business owners, and we remain hopeful that the Senate and the President will follow suit so that much needed regulatory reforms will be signed into law. It is also obvious, however, that we need the assistance of the fourth branch of government -- the regulators, if we are to truly bring about meaningful reform.

#### **The IRS's Regulatory Initiatives... The good with the bad**

The President and the Commissioner deserve credit for the steps they have taken in the last year to reduce the burden of tax regulations on small business owners. We were pleased to see the President's Memorandum issued in March to department heads calling for 1) cutting obsolete regulations, 2) rewarding results, not red tape, 3) creation of grassroots partnerships and 4) negotiating, not dictating.

We were also pleased to see the creation of the IRS Small Business Affairs Office; Commissioner Richardson's town meetings around the country with small business owners; recent IRS worker classification changes; the President's announcement on simplified wage reporting; the increase in the threshold for recordkeeping requirements for meals and entertainment deductibility from \$25 to \$75; and the IRS's response to the President's directive to eliminate and improve regulations.

All of these actions send a positive message to small business owners that the IRS is making an effort to change its ways.

#### **But...the Bad**

Good intentions don't always mean good results. The reality is that our members are still having problems with what they believe is an overzealous IRS intent on bullying them rather than helping them. The Administration's tone versus reality is illustrated best by a recent Washington University study which shows that the President's 1996 budget calls for a 6.3 percent increase in spending on regulatory programs.

Surveys of our membership and evidence from the White House Conference on Small Business leaves little doubt as to the degree of concern small business owners feel about IRS regulations. The NFIB Education Foundation, NFIB's research arm, published in 1992 an extensive survey entitled "Small Business Problems and Priorities." It ranked the top 75 problems facing small business owners. Problems associated with federal taxes on business

income ranked number two. Problems with unreasonable government regulations ranked number 8, behind only concerns related to FICA and state taxes, health insurance, cash flow, and liability insurance costs.

In the most recent data available from the NFIB Education Foundation's monthly "Small Business Economic Trends," taxes and regulations were the top problems facing small businesses in America. Moreover, the small business owners were asked to rate the Administration on economic policies. Forty-six percent of respondents gave the Administration a "poor" rating while only one percent gave the Administration an "excellent" rating.

The recommendations from the recent White House Conference on Small Business corroborates the high priority small business owners place on reforming taxes and regulations. Six of the top ten recommendations dealt with reforming taxes or regulations.

#### Examples

##### 1) Worker Classification.

Although we are pleased to see the Commissioner's efforts to rectify this issue, it is clear that the problem of IRS classification of workers as employees or independent contractors is still a paramount concern of small business owners. The reason reforming this problem was the number one issue of the White House Conference on Small Business is not just because of the hodge-podge and unpredictable application of the law by IRS agents; the concern is equally brought about because of the harsh enforcement tactics of the IRS for perceived violations.

For more than twenty years the IRS has run roughshod through small businesses doing audits to see if workers have been misclassified as independent contractors. Of course it is true that the IRS is prohibited barring Congressional action from issuing a regulatory definition for its agents and small business owners to follow. However, guidance is still issued with the clear intent of maximizing IRS withholding and erring on the side of classification of workers as employees. Because the 20 point common law test is not conclusive, and because each case is evaluated differently, small business owners never can really know how workers will be classified.

To make matters worse, the IRS levies heavy back tax penalties when it determines a company has wrongly classified an employee as an independent contractor. These fines are levied even if the mistake was unintentional, the employer fully reported all payments to the independent contractor and the contractor paid all applicable taxes.

Consequently, NFIB would urge the IRS to continue to work to better clarify the definition of independent contractors. Furthermore, because it is obvious that this problem will never be completely solved without a legislative solution, we urge all members of Congress to support H.R. 1972, sponsored by Congressman Jon Christensen. We would also hope that the U.S. Treasury Department will lend its support for this legislation.

## 2) Cash vs. Accrual Accounting.

The IRS's preference for accrual accounting -- because it is perceived to more accurately reflect income and bring in more revenue -- is well known. For small business owners, however, the use of accrual accounting does not adequately reflect the fact that a small business prospers or perishes based on cash flow. It is for this reason that small business owners prefer cash flow accounting.

Although current law does allow certain small businesses who are not retailers or wholesalers, and whose gross receipts do not exceed \$5 million to use cash accounting, it is clear from the many phone calls and letters we have received from NFIB members that a great deal of uncertainty remains as to what kind of small business owners are eligible to use cash accounting. Many small business owners believe that the IRS takes advantage of this uncertainty to impose penalties on the unwary. We at NFIB therefore would urge the IRS to enhance its efforts to ensure that small business owners understand whether or not they are eligible to use cash accounting. NFIB also supports legislation which would expand the availability of the cash accounting method.

## 3) Regulatory Flexibility.

As stated above in this testimony, the IRS has largely managed to avoid the requirements of the Regulatory Flexibility Act because it has defined its regulations as "interpretive" rather than non-interpretive rulemakings. Although NFIB is hopeful that a legislative solution will require the IRS to assess and minimize the impact on small business for all new regulations, we would like to see the IRS addressing small business concerns every time a new rule is issued.

## 4) Lifestyle Audits.

Perhaps the most egregious example in our members minds of IRS power gone out of control is the lifestyle audit. The idea that an IRS agent can come into and thoroughly search the place of business or even the home strikes fear in all of our members. Stories like these that we have all heard and are contained in NFIB files of member correspondence are perhaps a primary reason that the IRS has developed such an adversarial relationship with small business owners.

## Recommendations

NFIB has the following recommendations for both the Congress and the Administration:

- 1) For the long term, pass a complete overhaul of the tax system.
- 2) Pass the Christensen independent contractor bill (H.R. 1972).
- 3) Pass the regulatory reforms contained in H.R. 9, including the Regulatory Flexibility Act reforms.
- 4) Pass the Amendments to the Taxpayer Bill of Rights as included in the House and Senate Reconciliation bills.

- 5) The final rule on the Paperwork Reduction Act should be reformed so that the IRS must comply with the Act's requirements for all of its regulations.
- 6) The IRS should further its efforts to encourage amicable resolution of disputes with small business owners -- through the use of methods such as alternative dispute resolution, with peer review boards represented by small business owners and others who understand the small business perspective.
- 7) The IRS Small Business Affairs office should seek the assistance of small business associations to help ensure that the small business perspective is fully addressed in all IRS regulatory actions.

#### **Conclusion**

Madam Chairman, NFIB small business owners spoke loudly last election and they continue to shout for help. Their message to Washington is plain and simple -- **get government off our backs and out of our pockets** so we can do what we do best: build businesses, create jobs, provide for our families and make meaningful and constructive contributions to American society.

The IRS represents to our members the agency that imposes the greatest regulatory burden on small business owners. For these business owners there is probably no higher priority than drastically reducing this regulatory burden. Your Committee hearings on this issue are crucial because it ensures the accountability of the Administration to show that it accomplishes real changes to back up rhetoric. The same is true for the Congress -- by providing a forum for advocating small business concerns your Committee ensures that our voice is heard. Regulatory relief initiatives can be proposed and vanish in the sunset of this town without making a fingerprint on the walls of America's small businesses. It is imperative that we have an accountability standard for the regulatory juggernaut that continues to haunt small business. Without any accountability, regulations will continue to stagnate this country's job creators -- small business owners.

Thank you Madam Chairman for your leadership on this issue and for holding this important hearing and we look forward to much more dialogue like we have had today.

**October 25, 1995  
PUBLIC HEARING**

**HOUSE SMALL BUSINESS COMMITTEE  
STATEMENT OF**

**WILLIAM P. FISHER**

**EXECUTIVE VICE PRESIDENT  
NATIONAL RESTAURANT ASSOCIATION**

Madame Chairman and members of the Committee, thank you for inviting me here today.

I am Bill Fisher, Executive Vice President of the National Restaurant Association. Our association represents the U.S. foodservice industry, an industry made up of nearly 740,000 units and dominated by small businesses. Nearly three out of four eating and drinking places have annual sales under \$500,000.

Last year we participated in the Small Business Forum on Regulatory Reform, cosponsored by the U.S. Small Business Administration and the Office of Management and Budget's Office of Information and Regulatory Affairs. At that time, we highlighted a problem of increasing concern to many foodservice operators. This involved the IRS's interpretation of an income tax credit available to restaurants for the FICA taxes they pay on tips above the amount of tips used to satisfy minimum wage requirements. To date, the IRS has chosen not to address this problem.

Let me provide some background. The provision in question, included in the 1993 tax bill, passed with solid bipartisan support and established what is now known as the Section 45B income tax credit.

Several months after the legislation was signed into law, the IRS issued a temporary regulation significantly altering the way the credit is applied. The statutory language is clear: It authorizes the 45B income tax credit for "*any tax paid*" by the employer during the taxable year. The statute does *not* restrict the credit either because the FICA tax paid by the employer is based on previously unreported tips, or because those tips were received prior to Jan. 1, 1994. If the employer pays FICA taxes after December 31, 1993, the statute allows the employer to take a business tax credit.

Yet, the IRS's temporary regulation, codified at Section 1.45B-1T, usurps congressional authority and intent by restricting the 45B credit in just this way. Part (a) of the regulation permits the credit *only* for reported tips, while part (b) additionally restricts the credit *only* to tips received by an employee *after* December 31, 1993.

The IRS's effort to limit the 45B credit to taxes paid on reported tips received by employees after December 31, 1993, has generated problems from the start. Last year, shortly after the IRS released its temporary regulation, a bipartisan group of more than 100 members of Congress wrote to then-Treasury Secretary Lloyd Bentsen to tell him the IRS's interpretation was wrong. Let me read an excerpt: "Congressional intent is clearly embodied in the statutory language, which provides the credit for FICA taxes paid after December 31, 1993." The signatories went on to make a request of Secretary Bentsen: "We strongly urge you to direct the IRS to issue new regulations that would not alter the meaning embodied in the statutory language in any way." The lawmakers who signed the letter included the original authors of the 45B credit.

Yet the IRS continues to refuse to implement the law as written, and that is why we are here today. In short, not only does the IRS's refusal conflict with the plain language of the statute: It also means tens of thousands of small restaurant operators continue to live in jeopardy of back tax bills that could literally wipe out their businesses.

Operators are caught in a dilemma. Under the Fair Labor Standards Act, all tips belong to the employee. The employer is neither authorized nor allowed to report tips on behalf of an employee. However, the Internal Revenue Code holds an employer liable for the payment of FICA taxes on unreported as well as reported tips. Thus, there are instances when an employer is made to pay additional FICA taxes because employees underreported their tips. The threat of back taxes is severe. An employer who has fully complied with the law – who has explained to employees their obligations under the law, collected tip reports from employees as required, and paid all taxes due on tips – can find itself years later with a tremendous back tax bill. This can be financially devastating to an employer whose profit margins typically run 3-5%. Not only do these employers find themselves with a huge and unexpected tax bill; under the IRS's interpretation, they are prevented from taking the business credit Congress intended under Section 45B.

The audit threat is compounded by the IRS's audit methods. In the vast majority of these cases, these back tax bills are presented to the employer alone. In most cases, the IRS never contacts the employees who failed to report these tips, never collects the employee half of the FICA tax, and never credits the payments to employees' Social Security wage history accounts.

Leaving aside these complaints about the IRS's audit tactics, however, the 45B statute provides a tax credit when these audits occur. This is not only consistent with the language of the statute, but with related parts of the tax code. Section 3121(q) of the Internal Revenue Code, which gives the IRS the right to collect the employer share of FICA taxes on previously unreported tips, specifically notes that these taxes are not deemed to be paid until the employer receives "notice and demand" from the IRS. This provision, in effect, treats unreported tips from previous years as if they were reported for employer tax purposes in the year the employer receives notice and demand. The 45B FICA tax credit was designed to give a business credit consistent with this intent.

Given the consistency of the 45B credit with related provisions of the Internal Revenue Code and the strong congressional support for the statutory language, we encourage Congress to make certain the IRS enforces the law as written. In fact, the House Budget Reconciliation bill includes language which effectively overrules the IRS regulation. We applaud the Ways and Means Committee for including this important provision in the legislation.

Finally, I would like to make it clear that the National Restaurant Association does not condone any underreporting of tip income, or any attempt to evade taxes

that are owed. However, the IRS's restrictive interpretation looks to us as if the agency is attempting to accomplish through regulatory fiat something that expressly contradicts the statute. Whether or not the IRS *likes* the statute, the fact remains that the statute *is* the law. The IRS must not be permitted to change the statute's application to tailor the credit to the IRS's ends.

Thank you for inviting us to testify today.

Madam Chairman and members of the Committee, I am Jeff Joseph, Vice President for Domestic Policy at the U.S. Chamber of Commerce. The Chamber is always pleased to testify before this Committee as we have often done. After all, of our more than 215,000 business members, 96% have fewer than 100 employees and 70% have fewer than 10. Just as small business is the backbone of our national economy, it is the backbone of the Chamber.

And, of course, when you start talking about small business issues, taxes immediate leap to the front. We recently surveyed members of GAIN, the Chamber's Grassroots Action Information Network, and of the more than 7,000 responses, over 6,000 were small businesses.

Their tax priorities, I am sure, will come as no surprise. They would like to see a capital gains tax reduction. They favor expansion of home office deductions and IRA's, the self-employed health insurance deduction, and increased expensing allowance for equipment purchases. Reform of the alternative minimum tax, estate and gift tax, and the S

Corporation rules are also on their minds.

Other items that ranked as very important to them include the clarification of the definition of an "independent contractor", additional Taxpayer Bill of Rights provisions, and the simplification of IRS tax and wage reporting requirements. Clearly, your hearing today is timely and on topics that small businesses care about very deeply.

The Chamber is a membership driven organization that operates through a series of special advisory committees including a Taxation Committee and a Council on Small Business. I am pleased today that my job really is to simply introduce an individual who serves on both of these committees. Ken Wolfe, a practicing CPA from Fort Mitchell, Kentucky, can provide you first hand information from the trenches about the real problems of real small businesses as they try to deal with the morass of paperwork and regulations that emanate from the IRS.

I would add that Ken was also a delegate to the White House Conference on Small Business that was held this earlier this year. He can also offer his thoughts on that experience as well.

**GAIN SURVEY RESULTS**  
**AUGUST, 1995**

**Percent of those Surveyed who Consider  
the Issue to be "Important" or "Very Important"**

<u>Issue</u>	<u>Based on 7,173 Total Respondents</u>	<u>Based on 6,030 Respondents with 100 or Fewer Employees</u>
<b>Capital Gains Tax Reduction</b>	86%	86%
* <b>Clarification of the Definitions of Independent Contractor/Employees</b>	78%	79%
** <b>Expansion of Home Office Deductions</b>	55%	57%
<b>Expansion of IRAs</b>	88%	89%
** <b>Increased Expensing Allowance for Equipment Purchases</b>	93%	94%
<b>Estate and Gift Tax Reform</b>	86%	87%
<b>Alternative Minimum Tax Reform</b>	81%	84%
* <b>Simplification of IRS Tax and Wage Reporting Requirements</b>	96%	97%
** <b>S Corporation Reform</b>	70%	74%
* <b>100% Deductibility of Self-Insured Health Insurance</b>	90%	92%

- \* Not contained in either the House or Senate budget bill
- \*\* Contained in House budget bill, but not in the Senate budget bill

Statement of

**Margaret Milner Richardson  
Commissioner of Internal Revenue**

Before the

House Committee on Small Business

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**Initlatives to Reduce Burdens  
on Small Business**

October 25, 1995



STATEMENT OF MARGARET MILNER RICHARDSON  
COMMISSIONER OF INTERNAL REVENUE  
BEFORE THE  
HOUSE COMMITTEE ON SMALL BUSINESS

October 25, 1995

Madame Chair and Distinguished Members of the Committee:

I appreciate the opportunity to be here today to discuss the efforts of the Internal Revenue Service to make the federal tax system fairer, simpler, and more efficient for small businesses. I have spent more than a quarter century working on tax issues -- both in and out of government. I understand that small businesses have concerns about the tax system that are unlike those of many individual taxpayers and many larger businesses.

Three out of four individuals do not itemize their deductions, and two out of three pay a flat tax at a 15 percent rate. At the other extreme, big businesses face complex rules but are undaunted because they have the resources to make sure they can minimize their tax bills. In the middle of it all is the small business that must face essentially the same rules that apply to big businesses, but without the resources to do so. I welcome the opportunity today to discuss the concerns of small business and what the Internal Revenue Service is doing to address those concerns.

My staff and I have devoted a considerable amount of time to small business issues. We recognize that we cannot expect small business owners to comply fully with the tax laws unless they first understand their tax obligations

and then have the tools they need to satisfy their obligations quickly and cost-effectively. For that reason, approximately a year and a half ago, we made a commitment to do what we could to assist small businesses.

We started by going directly to small business owners to listen to them. During the spring and summer of 1994, OMB's Office of Information and Regulatory Affairs and the Small Business Administration jointly sponsored a forum here in Washington on regulatory reform for small businesses. The IRS participated, along with five other federal agencies, in a series of workshops focusing on several small business industries, and we listened to the concerns of small business owners and their representatives. At my request, the IRS held a special series of workshops as part of that regulatory forum to focus specifically on IRS issues.

To participate in this regulatory forum, I established a new IRS Office of Small Business Affairs and appointed Barbara Jenkins, who is with me here today, as its Director. I believed we needed a group of people within the IRS, reporting directly to the Commissioner, who have responsibility for focusing on the concerns of small businesses. Since that office was established, a year and a half ago, Barbara and her staff have been working hard with me and with many others at the IRS to improve the services our organization provides to small business. It is because of that work that I am pleased to be here testifying this morning.

Our opportunities for listening expanded when President Clinton announced his regulatory reform initiative in March of this year and asked that the head of each federal regulatory agency get out of Washington to talk directly with the regulated community. I chose to take that opportunity to mobilize the Office of Small Business Affairs and hold a series of small business town meetings. I

personally conducted seven of those meetings in towns all across the country. We listened long and hard to the concerns of small business owners, and, when each of these meetings was over, we promised to take their concerns back to Washington and address the ones we could.

The IRS also participated this year in the White House Conference on Small Business. Our participation included representation at many of the state conferences and all the regional conferences and culminated in a presentation I made at the national conference here in Washington in June. I also had the opportunity to participate in a two-hour open Question and Answer session at the national conference, so I did a fair amount of listening to small business owners that morning.

I want to report to you today what we have learned from listening to hundreds of small business owners about the tax system, and what we have begun to do about what we have learned. I recognize that we have not heard from everyone -- and I know there are many points of view and many different stories to tell. I also recognize that we do not have the solutions to all the concerns that we have heard so far. I want to make clear, however, that no one should be suffering from the misunderstanding that the IRS is a large, impersonal organization with neither time nor desire to address the concerns of small businesses. We look forward to receiving input about our efforts from this distinguished Committee, as well as from the other members of this panel.

So far, the small business owners we have listened to have told us that they want very much to comply with their tax obligations. But, as I mentioned a minute ago, they also told us that we cannot expect small business owners to comply fully with their tax obligations unless they understand those obligations and have the proper tools to satisfy their obligations quickly and cost-effectively.

Accordingly, our efforts to help small businesses have been directed at both increasing their understanding of their tax obligations and providing them with effective tools for satisfying those obligations.

## INCREASING UNDERSTANDING

### **Small Business Education**

The most direct and effective way of increasing the understanding of small business owners about their tax obligations is to provide them with a workshop or training program where they can get personal instruction and ask specific questions. Currently, every IRS office conducts a taxpayer education program that incorporates taxpayer workshops on a wide variety of tax topics, including workshops on small business tax issues. In response to hearing about the need for better education programs for small business owners, we are now exploring how we can customize the workshops to specific industries and how best to use our workshop resources to get small businesses the kind of training they need most. Already, we have conducted industry-specific small business programs, which have been successful and well-received. For example, in New Hampshire, we held a workshop for restaurant owners and, in Austin, Texas, we held a workshop for small businesses dealing in international trade.

We are also exploring the possible development of a more extensive education program in partnership with the Small Business Administration's Small Business Development Centers. Such a partnership would provide tax information and education to all small business owners using the Centers and could result in a much wider distribution of tax information at the local facilities in the SBDC network.

## **Small Business Tax Education Kit**

Today, I brought with me an information kit. The kit contains material designed to educate small business owners on a variety of topics like employment taxes, record keeping requirements, and self-employed retirement plans. We distribute these kits to about 2,500 organizations nationwide, including colleges, universities, and business training centers. These organizations then use the materials in programs for teaching small business owners about the federal income tax system.

As part of our effort to improve small business education and because of what we learned in our town meetings, we are now working with an outside contractor that specializes in producing educational materials to make the contents of the kit more helpful.

## **IRS Notices**

We recognize that we can help small business owners understand their tax obligations not only through formal education programs but also through providing them with clear, helpful information when we contact them about a specific problem or task. We learned in our regulatory reform workshops and at our town meetings that some of our written notices, hundreds of thousands of which are issued to small businesses each year, are often not helpful to those small businesses.

In response, we have begun a complete overhaul of our taxpayer notice system. Our notice redesign project will improve the quality, content, and format of our notices so that small business owners -- indeed, all taxpayers -- can understand and know how to respond to a notice without having to call us for an explanation. Our goal is to have several of our high-volume notices redesigned

by the end of this year. We have also begun a broader notice reengineering project to take a hard look at our use of notices and to make cost/benefit determinations about that use. The Office of Small Business Affairs is part of these notice reinvention efforts so that the needs and concerns of small businesses are properly taken into account.

### **Regulatory Reinvention**

The IRS can also improve understanding of the tax laws through regulatory reinvention. When talking about regulatory reinvention or "reg reform," I think it is important to point out that the IRS is somewhat different from many other government regulatory agencies. In general, the IRS issues regulations to interpret specific tax rules written by Congress and to help taxpayers better understand and meet their tax obligations. That is, our regulations generally do not impose new requirements or sanctions on taxpayers. Rather, they typically describe requirements and sanctions imposed by Congress and attempt to give taxpayers guidance on how to comply with them. As a result, the IRS is often cited for not issuing regulations quickly enough rather than for issuing too many regulations. For example, last December, the GAO reported on interviews it held with businesses about the burden of government regulations and cited the IRS's problem as a lack of regulations, not an excess. The GAO report stated:

Of those [tax advisors and officials of the businesses interviewed] who cited difficulties with the IRS, problems identified were ... the amount of time IRS takes to issue regulations .... For many tax provisions businesses depend upon IRS regulations for guidance in complying with the code and correspondingly reducing their burden. Without timely regulations, according to some respondents,

businesses must guess at the proper application of the law and then at times amend their decisions when the regulations are finally issued.<sup>1</sup>

Because our regulations serve this important purpose of helping taxpayers understand their obligations, we found in the workshops that were part of the SBA/OMB Forum on Regulatory Reform that most small business owners think the IRS regulatory process should be improved and streamlined so that more useful regulations can be issued more efficiently. This was echoed in our town meetings. The small business owners we talked to asked for (1) simpler regulatory language; (2) earlier involvement in what regulations say; and (3) an easier way to access regulatory information.

In response to the request for easier access to simple explanations of regulatory requirements, we recently implemented a procedure that should help all taxpayers, but which was particularly designed for small businesses without specialized legal counsel. Under this procedure, each new regulation is accompanied by a brief, one or two-page description, in non-technical language, that sets forth the subject matter of the regulation, describes the taxpayers who may be subject to it, and instructs the reader on where to go for further information and how to provide comments to the IRS. Within the next two weeks, these summaries will be available on FedWorld, a government-sponsored electronic information service, accessible via the Internet. Our intent is to provide small businesses with a simple and inexpensive way of finding out what regulatory actions we are taking and how they can get involved in the process.

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<sup>1</sup> Tax System Burden: Tax Compliance Faced by Business Taxpayers (GAO/T-GGD-95-42, December 9, 1994).

To facilitate involvement of small businesses in the regulatory process further, it was suggested in the SBA/OMB Forum on Regulatory Reform that we extend the comment period we normally provide for proposed regulations from 60 days to 90 days. We responded immediately by doing just that. In addition, next year, we plan to put the entire text of all our new regulations and proposed regulations on the Internet, and we will allow taxpayers to comment on proposed regulations by transmitting their comments to us electronically. We believe these changes to our current Federal Register procedures will make it easier for taxpayers, especially small business owners, to become involved in our regulatory process.

We have also recently completed some important regulatory housekeeping. As part of the President's Regulatory Reform Initiative, this summer we conducted a page-by-page review of all our existing regulations and, based on that review, have proposed to withdraw more than 30 obsolete regulations, amounting to over 160 pages in the Code of Federal Regulations. We are now waiting for public comment on that proposal and hope to be able to eliminate these regulations by year-end.

## **Publications**

Most small businesses can meet all of their federal tax responsibilities without ever referring to official IRS regulations. The IRS issues hundreds of free information publications, many of which are designed to provide guidance to businesses on all their tax obligations including those originating in regulations.<sup>2</sup>

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<sup>2</sup> For example: Publication 15, Employer's Tax Guide; Publication 535, Business Expenses; Publication 534, Depreciation; Publication 594, Understanding the Collection Process.

Publication 553, for example, provides taxpayers with guidance on tax law changes occurring during the year. Publication 334, Tax Guide for Small Business, provides in one place comprehensive tax information for sole proprietorships, partnerships, and corporations regarding filing, deposit, and regulatory requirements. Several publications explain rules regarding specific topics, such as qualified retirement plans.

One of the responsibilities of our Small Business Affairs Office is to work with our Tax Forms and Publications Division to ensure that the needs of small business are being met by these publications. For example, as a result of feedback received at our IRS town meetings, Publication 583, Starting a New Business and Keeping Records, is being revised to better explain record keeping requirements for small businesses, and should be available to the public in early January.

### **Specific Small Business Issues**

Perhaps one of the most important ways we can increase small business owners' understanding of tax obligations is to be on the look out for specific issues they face and to address those issues reasonably and efficiently. In the past two years, we have issued administrative guidance addressing many small business issues in this manner. Where the source of complexity is statutory, we generally work with the Treasury Department to help craft legislative proposals that would provide additional relief for small businesses.

I want to mention three specific issues we have recently addressed administratively.

Worker Classification:

We know that an issue of great concern to small businesses is how workers are classified -- in other words, whether they are employees or independent contractors. The participants of the White House Conference on Small Business identified worker classification as their number one issue of concern.

Worker classification depends on a common-law standard which essentially asks whether the business has the right to "direct and control" the worker. The courts have traditionally looked to a variety of evidentiary factors in applying this test, and the IRS has therefore adopted those factors in examining this issue. The problem has been that the factors are too numerous, too complex, and many of them just do not fit for particular businesses. What is needed are simple, uniform definitions of "employee" and "independent contractor." This, of course, the IRS cannot provide under current law.

I have said in public several times recently that it does not matter to the IRS whether a worker is classified as an employee or an independent contractor, so long as the worker, whether under the withholding rules or under the rules governing the self-employed, is paying his or her proper amount of taxes. Essentially, our agents should be doing the best they can to make an accurate worker classification determination under the complexity that is the common law. A straightforward definition would ease our burden, as well as the burden on taxpayers.

We know, however, that we cannot wait for these more wide-ranging changes to be accomplished. On August 2 of this year, the National Director of our employment tax programs testified on the subject of worker classification before this Committee's Subcommittee on Taxation and Finance. At that time he

announced that the IRS was developing changes to our approach to the worker classification issue in our employment tax audits. I would like to update the Committee on the initiatives that were announced at that hearing.

First, we announced that we were requiring the approval of our national office here in Washington of all large worker classification projects. This means that if one of our local offices wants to start a project for examining worker classification in an entire market segment or geographic area, national office approval is required. These procedures have now been implemented, and we believe they will ensure uniform treatment and appropriate use of the IRS' resources.

Second, we said that we would develop training materials for IRS examiners handling worker classification issues that emphasize the principle that using independent contractors can be a legitimate business practice that will not be challenged by the Service. We are now developing this material and a draft should be available early in November for review and comment by the private sector, including small business. We expect to complete the training of our examiners by the end of January 1996.

In addition to these initiatives announced at the August 2 hearing, we have now completed a thorough review of our existing employment tax compliance programs. As a result of this review, we are taking steps to ensure that our audit approach on the issue of worker classification embodies the following principles:

- Worker classification issues should be resolved as quickly as possible and as early in the administrative process as possible.
- Worker classification issues should be resolved uniformly throughout the country.

- Resolution of worker classification issues should take into account a taxpayer's past compliance with section 530, as well as the common law standard.
- The IRS' compliance programs should encourage correct classification and correct reporting of payments to workers.
- Reclassification of workers who have legitimately been treated as independent contractors must be avoided.

The IRS plans to propose for public comment a new initiative based on these principles early in November, at the same time training materials are released.

Restaurant Worker Tip Reporting:

For many years, the IRS and the restaurant industry have struggled with difficult issues regarding the proper reporting of tips received by restaurant workers. After long negotiations and careful listening to the industry, some of which occurred during my town meetings earlier this year with small businesses, we announced in May that we had developed an agreement on reporting issues with a coalition of food service industry representatives. This agreement is known as the Tip Rate Alternative Commitment or "TRAC."

Under TRAC, an employer who voluntarily agrees to the commitment must establish reasonable procedures to report future tips, establish a program to educate all employees who receive tips, and deposit federal employment taxes on those workers promptly. In return, the IRS generally will agree not to initiate an examination of the employer that might result in an assessment of tax for its employees' unreported tips for prior years. Currently, we are developing a training package for agreement participants, and it will be available next month.

Our success has been highly acclaimed across the country. For example, a member of the board and past president of the Oklahoma Restaurant Association, David Egan, was quoted in the Sunday Oklahoman as saying that “[t]his is a remarkable workout between the restaurant industry and the IRS.”

I want to congratulate the restaurant industry on this shared success. I think the TRAC agreement is a very fine example of what we can do with the most difficult of issues if we set out to cooperate with private industry and agree to respect one another’s interests.

Entity Classification:

My last example of a difficult small business issue we are addressing is the determination of whether an unincorporated business should be taxed as a partnership or as a corporation. Currently, that determination is made under a complicated set of regulations based on old case law. For the well-advised, those rules are easily manipulated to achieve a desired result, but at the same time the rules are extremely complex and full of pitfalls for smaller entities without sophisticated counsel. Therefore, in March of this year, we proposed a major initiative to allow unincorporated businesses simply to elect whether they want to be classified as a partnership or a corporation. This new classification election will be quick, simple, and hassle-free, and will save resources for both taxpayers and the government.

Since we announced this idea in March, we have received about 50 formal letters of support from groups representing tens of thousands of small businesses. At a July 20, 1995 public hearing, we heard testimony from many private sector witnesses who also expressed overwhelming support for the initiative. We hope to propose regulations implementing this concept as early as the end of this year, and to finalize new rules next year.

## **PROVIDING EFFECTIVE TOOLS**

As I have mentioned, small business owners told us that they need to understand their obligations, but that they also need to have the proper tools to be able to comply with those obligations quickly and with little cost. I would like to describe some of the things we are working on to give small businesses those tools.

### **Access to Tax Information and Assistance**

We have improved taxpayer access to tax information. For example, since December of last year, taxpayers have been able to get copies of most IRS forms and publications electronically from the Internet or by dialing into FedWorld, and they have been able to get them on a CD ROM. These documents can be down-loaded to personal computers and printed at the taxpayer's home or office.

The IRS has also joined with the Department of Commerce and 14 other government agencies to establish the U.S. Business Advisor -- a one-stop Internet shop that directs small business owners to government information available on-line, including the electronic IRS cite for forms and publications I just mentioned.

For small business owners seeking specialized tax assistance, the IRS was a partner in the development of the first U.S. General Store for Small Business opened in Houston, Texas in July of this year. This store, which is supported by 14 other federal agencies, provides one-stop government service to businesses, ranging from assistance in complying with regulations, to solving tax problems, to obtaining loans. The IRS now has two full-time employees working

in the Houston Store and is working with other federal agencies on plans for the development of additional General Stores in other locations across the country.

The concept of providing one-stop assistance to small businesses is not new to the IRS. Our Buffalo Assistance Center recently celebrated its second anniversary of offering one-stop service for prospective or existing business owners. During its first two years, the Center has helped over 10,000 small businesses across the country by providing one-on-one counseling, group seminars, assigning employer identification numbers, and providing answers to specific questions.

We are also working to expand the tax information and assistance we make available on the Internet. Next year, information available on FedWorld will be broadened to include "Dear IRS," a searchable list of frequently-asked tax questions, and answers to those questions, as well as a "Tax News" service to help businesses, practitioners, tax software companies, and the media stay on top of the latest tax developments. In addition, the technical tax topics that are now available on our TeleTax system -- an automated telephone assistance line - - will be made available on FedWorld, and several of our publications for businesses will be presented in an electronically searchable format.

### **Forms and Paperwork**

Although our tax forms are frequently cited in discussions about complexity, I would point out that often complexity in the forms simply reflects a complex area of the law, and that our forms can be quite useful in helping taxpayers comply with their obligations. Our basic approach to developing forms and instructions has been to allow taxpayers to complete them without having to seek out provisions of the law or regulations. At the same time, we understand

the need to keep the forms as simple as possible, and we are continually working to do so.

For small businesses, we recently introduced a new Schedule C-EZ, used by sole proprietors to compute their net profit for the year. The Schedule C-EZ allows taxpayers to compute their net business profit on only three lines, instead of the 36 lines that are included on the full Schedule C. Nearly 2 million taxpayers are now using the new Schedule C-EZ.

Last December, we simplified reporting of employment taxes by removing non-payroll reporting requirements, such as backup withholding, from the Form 941. This change reduced paperwork burden for an estimated 6 million employers and saved them 13 million hours in reporting time annually. In addition, Form 1065, used to report partnership income, was revised significantly in 1993. We changed reporting requirements for balance sheets and assets to reduce burden for an estimated 800,000 small businesses.

As you know, the Administration strongly supported the Paperwork Reduction Act of 1995, which became effective just three weeks ago. This new law substantially increases opportunities for the public to participate in the notice and comment period for proposed forms and paperwork requirements in proposed regulations. The law will increase the public's opportunity for comment on paperwork requirements, and we at the IRS are hopeful that it will bring a substantial increase in the number of thoughtful suggestions we receive from the public for form simplification.

While we are working hard to reduce paperwork burden by streamlining the content of our information requests from taxpayers, we also believe that the ultimate solution to paperwork issues lies in finding ways to use new technologies so that taxpayers can communicate with their government as easily as they

communicate with many segments of the private sector. We have recently made great strides in devising alternative, user-friendly methods of filing tax information with the IRS.

We continue to expand our programs for electronic return filing. Many small businesses are self-employed individuals filing the Form 1040 with the Schedule C or Schedule C-EZ. These returns can now be filed by electronic means quickly and with much fewer errors so that chance that there will be a need for post-filing correspondence with the IRS will be reduced significantly.

In October of 1994 we began a pilot program to allow employers to file their quarterly payroll tax returns (Forms 941) by electronic means. The IRS has received and processed more than 100,000 such returns so far and intends to expand the program because of its success. In January, we will begin to test in the State of California a project that will allow small businesses to meet their federal and state employment tax filing requirements with a single electronic transmission.

### **Record Keeping**

At our small business town meetings, we were asked to focus some of our efforts on our record keeping requirements, so we have been doing just that. I asked a task force in the national office to work with our Office of Small Business Affairs to review all our small business record keeping requirements. The group came up with 35 recommendations for easing these requirements. Our next step, scheduled to begin next month, is to test these recommendations with small businesses.

But even more exciting is the fact that, last month, we announced perhaps the most significant change in the record keeping area in years. Since 1962, the

threshold for which businesses are required to have a receipt for a travel or entertainment expense had been \$25. Effective on October 1, we raised that threshold to \$75. We know that, for small businesses in particular, the \$25 threshold had been difficult. The new threshold should make record keeping a lot less challenging for both businesses and employees and is part of our ongoing efforts to make government work better and cost less for everyone.

### **Payment Tools**

We are also working to make it easier for businesses to make their tax payments. We have developed an electronic federal tax deposit system, which we call TAXLINK, that allows businesses to make their payroll and estimated tax deposits by making a phone call, rather than by taking a trip to the bank to deposit a check with a paper coupon. We have heard about some small business owners having to close their businesses for hours in order to drive to the nearest bank to make their deposits. Hopefully, TAXLINK will eliminate this kind of counterproductive activity.

We are now studying whether TAXLINK adequately takes into account all the needs of small businesses. For that purpose, we conducted an extensive customer satisfaction survey of current TAXLINK users to determine whether we needed to make any changes. We were extremely pleased to see the results of that survey. Approximately 98 percent of the businesses using TAXLINK are satisfied with the system. When asked if TAXLINK saved them time, 86 percent said "yes" and, when asked if TAXLINK was easy to use, 79 percent also said "yes." Our goal now is to make sure that small businesses are aware of the benefits of this new system and that it is available to them today.

Before closing, I want to point out that all our programs involving electronic and telephonic filing, paying, and assistance, many of which I have discussed today, are our most promising from the perspective of giving small businesses the tools they need to comply with their obligations simply and inexpensively. But I also note that these programs are only possible because of investments we have made so far in Tax Systems Modernization. The future growth and success of these important programs, which again are our most promising, depends entirely on our ability to continue these investments in the future.

### CONCLUSION

We at the IRS are committed to addressing the concerns of small business owners about difficulties they face in understanding and satisfying their tax obligations. I have attempted to outline for you this morning some of our early successes and to indicate to you where we plan to concentrate our efforts in the coming months.

We are anxious to continue building on the progress we have made in the past two years. Unfortunately, because of the current budget environment and the significant reductions that have been proposed in our FY96 appropriation, our ability to deliver the kinds of services all taxpayers, including small businesses, deserve will be severely curtailed. But, despite budget constraints, this agency will continue to strive to make the tax system less taxing for individuals, small businesses, and large businesses as well.

As I said at the outset, I look forward to any comments or suggestions the members of this distinguished Committee may have on our efforts and would be happy to answer any questions you may have at this time.



***National Association for the Self-Employed***

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**TESTIMONY OF**

**BENNIE L. THAYER**

**PRESIDENT**

**THE NATIONAL ASSOCIATION FOR THE SELF-EMPLOYED**

**BEFORE THE**

**COMMITTEE ON SMALL BUSINESS**

**U.S. HOUSE OF REPRESENTATIVES**

**ON**

**THE INTERNAL REVENUE SERVICE'S INITIATIVES TO**

**REDUCE REGULATORY AND PAPERWORK BURDENS ON SMALL BUSINESS**

**OCTOBER 25, 1995**

***"Serving the Needs of Small-Business America"***

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Member Services: 2121 Precinct Line Road • Hurst, TX 76054 • 1-800-232-NASE

On behalf of the National Association for the Self-Employed (NASE), I appreciate the opportunity to testify before the House Small Business Committee. My name is Bennie L. Thayer, the NASE's President; and I am pleased to testify today on the Internal Revenue Service's Initiatives to Reduce Regulatory and Paperwork Burdens on Small Business.

The NASE strongly supports the effort to reduce IRS regulatory and paperwork burdens, a topic of immense importance to our 320,000 small business members located throughout the United States. Over 85 percent of the NASE members are business owners with 5 or fewer employees. The membership represents a very wide range of businesses, notably in the consulting and retail fields. If you ask the average NASE member which federal agency creates the greatest number of administrative burdens and headaches for their business, the answer will usually be the IRS.

According to a recent NASE survey, 82.4 percent of the respondents stated that the IRS imposed the greatest regulatory burdens on businesses when compared to other agencies. It is for this reason that the NASE welcomes the opportunity to comment on the issue of IRS regulatory burdens. We strongly support efforts to lessen the regulatory burdens placed on small business persons by the Service. The NASE believes such efforts should lead to an increase in the respect taxpayers have for the tax administration process and thus, result in a meaningful increase in taxpayer compliance rates overall.

#### Congressional and Administration Efforts to Reduce Regulatory Burdens for Small Business

We are well aware of the hard work by Madam Chair Meyers and the House Small Business Committee in obtaining passage earlier this year of the Paperwork Reduction Act of 1995. Through passage of this Act, Congress has taken critical steps to reduce the paperwork morass imposed on small business by government. The NASE stands ready to work closely with the House Small Business Committee to ensure effective implementation and compliance by federal agencies with the Act.

The Clinton Administration has taken steps designed to lessen the regulatory burdens for small business persons and other taxpayers. In this regard, President Bill Clinton announced in March 1993 his quest for a National Performance Review -- a blueprint for "reinventing government." The President reaffirmed his commitment to reducing regulatory and paperwork burdens this year as part of his Administration's efforts with respect to the 1995 White House Conference on Small Business.

Some of the major Administration recommendations for reducing regulatory burdens for taxpayers include the need to foster Federal-State cooperative initiatives by the IRS, simplified employer wage reporting, and improved IRS collection efforts. We believe that the Administration's stated intentions for these programs are very positive. The NASE is pleased to comment on some of these Administration initiatives, as well as some of the other more recent efforts on the part of Congress and the Administration.

The Regulatory Flexibility Act

We want to also thank Madam Chair Jan Meyers and the other members of the House Small Business Community for vigorously promoting legislation this year to reform the Regulatory Flexibility Act. Among other reform measures, this committee has promoted the need for making the Regulatory Flexibility Act subject to judicial review. The NASE is also pleased that the Clinton Administration lent its support in 1994 to strengthening the RFA, as well as in two separate recommendations by Vice President Gore's Reinventing Government Task Force.

But to accomplish this, the RFA must be a law Congress and constituents can depend on. Unfortunately, that has become less true over time. Many agencies -- and particularly the IRS -- routinely ignore the Congressional intent behind the enactment of the RFA in 1980. In fact, the Internal Revenue Service claims that it is entitled to a blanket exemption from the RFA. An excellent example as to how the IRS routinely ignores the RFA can be established by reviewing the agency's handling of Section 89 of the Internal Revenue Code.

In 1988, the Internal Revenue Service proposed new regulations under Section 89. These regulations would have dealt with tests and data collection required of businesses to prove nondiscrimination in employee benefit plans. In the opinion of many in the small business community, as well as SBA's Office of Advocacy and a number of members of Congress, the objectives of Section 89 could have been met with far fewer paperwork and compliance burdens on small business than the IRS was proposing. However, the IRS maintains that virtually all of its rules are "interpretive" and therefore completely exempt from the RFA. So substantive comments and recommendations made by members of Congress, the small business community and the Office of Advocacy to the IRS for reducing the small business burden of the Section 89 regulations were ignored. Yet a judicial challenge under the RFA was not possible. The IRS' decision to press forward with the regulations as proposed led to the rapid emergence of a national grassroots movement to strike down Section 89. Congress was forced to intervene, and the issue mushroomed into a bitter election-year battle involving six Congressional committees, thousands of constituent visits and millions of pieces of mail. In the end, Section 89 was repealed altogether. It is not too much to say that if the IRS had conscientiously applied the RFA, or if the threat of judicial review of the RFA had been available, the entire episode could have been avoided.

The Regulatory Flexibility Act has enjoyed strong support because it is a responsible approach to a very real problem. Every member of Congress has heard the vigorously expressed concerns of small business constituents regarding federal regulations and paperwork. Federal agencies that comply with the RFA properly can go a long way toward addressing that public concern -- yet can do so without compromising their missions or their legal obligations. For members of Congress, the Act can provide a channel for turning constituent complaints about the "bureaucracy" into constructive solutions. Therefore, when Congress acts on **Regulatory Flexibility reform legislation** over the next few months, that legislation

should mandate that all agencies -- including the IRS -- are subject to judicial review.

#### **Taxpayer Bill of Rights**

The 1995 House budget reconciliation bill includes a Taxpayer Bill of Rights II. The NASE testified earlier this year before the House Ways and Means Committee in support of taxpayer rights legislation. We strongly support such efforts to improve the privacy rights of taxpayers and to ensure a more even-handed approach to enforcement of the tax laws.

The House Reconciliation bill provides taxpayers with increased rights with respect to liens and levies. The bill also creates an independent Office of Taxpayer Advocate, which effectively is designed to elevate the status and authority of the current Taxpayer Ombudsman. Under the legislation, the IRS is provided with increased authority to issue Taxpayer Assistance Orders. Other positive taxpayer rights measures in the legislation include more due process rights with respect to obtaining installment agreements or offers in compromise agreements, and relief from the retroactive application of IRS regulations. There are a number of other pro-taxpayer provisions in the Taxpayer Bill of Rights II as well.

The NASE believes the Taxpayer Bill of Rights II provisions are positive initiatives which should reduce regulatory burdens for taxpayers and in turn, lead to an increase in the respect taxpayers have for the tax administration process.

#### **Implementing the Small Business and Simplified Tax and Wage Reporting System**

The National Performance Review calls for the implementation of a small business tax and wage reporting system (STARS). Our association is pleased to have had the opportunity to send a representative to the panel which developed the concept and recommendations for implementation of the STARS program. According to the Third Report of the National Performance Review, dated September 1995, payroll recordkeeping regulations "are the most burdensome concern of businesses with 10 or fewer employees, or about 79 percent of American businesses."

In general, the STARS initiative will ultimately enable employers to file W-2 data through single returns filed electronically with both the federal and state governments. Moreover, the program is designed to simplify the laws, definitions, and procedures relating to tax and wage reporting. The STARS program potentially would lead to more uniformity with respect to wage reporting for both the IRS and Social Security.

The NASE strongly supports implementation of this initiative. We urge the Administration and Congress to take the critical steps necessary to foster Federal-State cooperation towards implementation of this program over the long-term, including implementation of pilot programs between the federal government and various states.

Another initiative designed to reduce regulatory burdens for small business include

more uniformity in Federal Unemployment Tax (FUTA) reporting between the U.S. Department of Labor and the IRS, and with the states. We view the FUTA proposal as conceptually similar to the STARS program and therefore, we support the FUTA initiative.

#### Simplification of Entity Classification Rules

On April 4, 1995, the IRS released Notice 95-14 stating that the agency is considering simplifying the classification regulations to allow taxpayers to treat domestic unincorporated business organizations as partnerships or as associations. In releasing the notice, the IRS stated that:

"The existing classification regulations are based on the historical differences under local law between partnerships and corporations. However, many states recently have revised their statutes to provide that partnerships and other unincorporated organizations may possess characteristics that have traditionally been associated with corporations, thereby narrowing considerable the traditional distinctions between corporations and partnerships. For example,...almost all states have enacted statutes allowing the formation of limited liability companies. These entities are designed to provide liability protection to all members and to otherwise resemble corporations, while generally qualifying as partnerships for federal tax purposes."

Notice 95-14 describes an initiative which -- on its face -- is designed to reduce regulatory burdens and thus, is pro-small business. While the NASE supports this proposal, we urge the release of more detail regarding how the IRS expects to implement the initiative.

#### Independent Contractor Status

A central theme of any investigation involving IRS regulatory burdens should include a review of the independent contractor issue. The small business community has long supported clarification of IRS rules and regulations relating to independent contractor status. This support has been largely fueled by the vigoroussness and intensity of IRS payroll tax audits over the years, which have focussed on employment classification issues. Unfortunately, these audits have been used by the IRS to reclassify individuals who ordinarily consider themselves to be independent contractors as employees, thereby stifling entrepreneurship and risktaking.

We understand that in the vast majority of audit cases, the IRS has reclassified the independent contractor as an employee. This scenario typically causes the business which hired the independent contractor to face costly fines and penalties. This results in a negative "domino effect" on small business:

- 1) First, the businesses that utilize independent contractors to perform short-term projects or provide consulting expertise become leery of utilizing independent contractors.

- 2) Second, this then has a direct impact on the independent contractors themselves who see businesses shying away from their services because of the fear of being audited.

In testimony before the House Small Business Subcommittee on Taxation and Finance, the IRS announced three initiatives designed to "improve" the agency's administration of the law and regulations involving independent contractors. These initiatives stress a more national focus and coordination in enforcement, with the intended result of bringing more uniformity to independent contractor audits; the need for improvements in the training of IRS auditors, and the importance of consolidating the process employers use with respect to questioning worker status classifications.

While the NASE applauds the stated intention of these IRS initiatives, we are extremely skeptical that the initiatives will ease the burden on small businesses when faced with an independent contractor audit. We are skeptical because our definition of regulatory improvements for independent contractors is likely to be the direct opposite of the IRS' view.

The NASE believes that any improvements in this area should be based on the premise of fostering the nation's entrepreneurial base -- and should not look for ways to impede the availability independent contractor status. In our view, these improvements should be based on a policy objective of trying to accommodate changes in the U.S. and global economies toward more -- not less -- flexibility in employment and contracting arrangements. Today, more than ever, as large companies downsize, more and more people are reentering the work force by putting their name on a "shingle" and going into business for themselves -- many as independent contractors.

We believe the best way to improve the situation for independent contractors is to enact H.R. 1972, introduced by Representative Jon Christensen and cosponsored by over 140 House members. The bill strikes a positive balance between the needs of the small business community, the nation's economy, and the tax administration process.

#### Meal and Entertainment Expenses

On September 29, 1995 the IRS announced in Notice 95-50 that it is increasing the threshold (from \$25 to \$75) for which the agency will require taxpayers to keep receipts with respect to verifying a deduction for meal and entertainment expenses. In announcing this change, IRS Commissioner Margaret Richardson stated, "This change is part of our ongoing efforts to make government work better and cost less." The stated rationale for the change was to make recordkeeping easier for businesses and employees.

The stated objective for this regulatory change is highly laudatory. Nevertheless, in order to make this IRS pronouncement work, the IRS will need to provide small business persons with clear guidance as to the type of records they will need to keep.

The Home Office Tax Deduction

The Small Business Committee worked very closely with the Ways and Means Committee to obtain inclusion of a home office deduction reform provision in the House's Contract With America Tax Relief Act of 1995, which passed the House on April 5, 1995. Home office deduction reform is needed to ameliorate the economic hardships caused by the 1993 U.S. Supreme Court decision in the *Commissioner v. Soliman* case.

The Finance Committee last week passed the revenue component of the Senate's 1995 budget reconciliation bill and unfortunately, its package does not include a home office deduction reform provision. The NASE strongly urges the Small Business Committee to continue its critical work on behalf of home office deduction reform. We recommend that the Committee work aggressively to ensure inclusion of the House's home office provision in any final budget reconciliation budget agreement.

**KWA****KOHLHEPP, WOLFE,  
and  
ASSOCIATES P.S.C.**

CERTIFIED PUBLIC ACCOUNTANTS

Kenneth R. Wolfe

Members:  
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Ohio Society of CPA

October 20, 1995

Congress  
United States House of Representatives  
104th Congress Committee on Small Business  
2361 Raeburn  
House Office Building  
Washington D.C. 20515-6315

The following is an outline of the comments to be made by Kenneth R. Wolfe at the October 25, 1995 Committee Meeting regarding regulations issued by the Internal Revenue Service.

1. It has been my observation over a number of years that the regulations being issued by the IRS have the force and effect of law, particularly since Congress has written tax law by stating the Secretary of the Treasury shall prescribe regulations. This gives these regulations the force and effect of law.

2. The regulations as indicated above are being issued quite late (later than the effective date of the law). It seems as a

matter of principle that tax law changes should not be made effective until the final regulations are issued. In the President's "Memorandum for Heads of Departments and Agencies", dated March 4, 1995, he directed the Departments and Agencies to focus on the following four steps, which are an integral part of the Regulations Reform initiative:

- a. Cut obsolete regulations
- b. Reward results, not red tape
- c. Establish grass roots partnership
- d. Negotiate, don't dictate

Since March of 1995, I have made the following observations regarding the IRS:

1. There has been a softening of language in some of the IRS notices to taxpayers.
2. There has been increased responsiveness via the telephone in making inquiries of IRS.
3. We still have the occasional IRS employee demanding payment and wanting to know when the proposed assessment is going to be paid,

prior to establishing whether or not the amounts are actually owed.

4. When the IRS districts are reduced, we do find that it is difficult communicating with other districts in different time zones.

An example of regulations getting worse would be home office.

IRS has moved the line. We were using the standard of primary place of business, used exclusively for business. Since the Solomon case, the IRS now requires that you must meet your customers in the home.

One other area of regulation that could be improved is the allocation of taxes paid. On occasion, there may be tax questions raised by IRS and the taxpayer will leave monies on deposit. For example:

a question arises in 1994 on a 1992 tax return. The taxpayer may leave taxes on deposit for 1994. At the resolution of the matter for 1992, if there is tax due and payable we should be able to allocate the deposits from the tax year 1994 to the tax year 1992. The service has difficulty in doing this.

An example of over regulation of small business is payroll taxes

Under the old deposit rules, if you taxes were \$3000 per month or

less, the taxes due were to be deposited by the 15th of the following month. That seemed to work well. If the taxes to be deposited were over \$3000 per pay period, the taxes due were to be deposited by three banking days from the actual payroll pay date. If deposit requirements were to be changed, the change should have been to increase the amount from \$3000.00 to \$5000.00 or \$7000.00 or to make all tax deposits three days after the actual pay date - regardless of the amount of the tax liability for the period. Instead, they went to one-eighth, semi-weekly payments which have confused Small Business and the individual taxpayer.

Kenneth R. Wolfe

**RESPONSES FOR HOUSE SMALL BUSINESS COMMITTEE**

**Q1:** *Will removing obsolete regulations result in burden reduction?*  
*(Page 57)*

A: In many cases, taxpayers can easily ascertain that obsolete regulations are indeed obsolete. In other cases, this may not be readily apparent. Removing obsolete regulations from the Code of Federal Regulations prevents taxpayers from reading the regulations before taxpayers ascertain that the regulations are obsolete. In this way, removing obsolete regulations reduces burden on taxpayers.

In connection with the President's regulatory reinvention initiative, the Internal Revenue Service (IRS) recently identified over 30 regulations that we propose to delete. Removing these regulations will reduce burden, although the burden reduction likely will be minimal. More importantly, in connection with the President's initiative, the IRS identified several regulations that we have "reinvented" or expect to "reinvent" in the near future. The IRS believes that the reinvention items, such as the "check-the-box" proposal, will significantly reduce taxpayer burden by simplifying existing rules or by providing guidance needed by taxpayers to comply with the tax laws.

**Q2:** *How many people in the Office of Chief Counsel participated in the review of tax regulations in response to the President's memorandum of March 4, 1995?*  
*(Page 57)*

A: Approximately 158 attorneys in the IRS Office of Chief Counsel participated in the page-by-page review of tax regulations in response to the President's memorandum of March 4, 1995. These attorneys in the aggregate spent a substantial number of hours on this effort, although, on average, each attorney spent only a few hours on the effort.

Q3: *Are any of the regulations that the IRS has or expects to "reinvent" or that the IRS has proposed to obsolete set forth in question and answer format? (Page 85)*

A: The prior regulations under Section 1.338 involving the consistency rules for certain stock acquisitions that are treated as asset acquisitions were in question and answer format. These regulations were revised in 1994; the new regulations are not in question and answer format. Certain existing regulations, for example regulations under section 35a.9999 (backup withholding, withholding on payments to foreign persons, and information reporting regulations) are in question and answer format. The IRS expects to issue regulations in the near future that will "reinvent" these regulations; the new regulations will not be in question and answer format. The IRS issues regulations in question and answer format when such format is the most appropriate means of promulgating guidance, taking into consideration the administrability of the regulation, the ability of the taxpayers to understand and apply regulations, and other relevant factors.

Q4: *How many regulations projects were closed in connection with the IRS' recent effort to close regulations projects that are not expected to be actively worked on in the near future? (Page 87)*

A: The IRS recently closed 222 regulations projects. See Announcement 95-90, 1995-43 I.R.B. 9. These regulations projects were closed because final regulations were issued or because we do not expect to actively work on the projects in the near future.

Q5: *How many private letter rulings were issued last year? (Page 103)*

A: For fiscal year 1995, approximately 2300 private letter rulings were issued. One should note, however, that approximately 3200 private letter rulings were requested. The difference in the numbers can be accounted for by the various reasons for not issuing a letter ruling, such as, taxpayer withdrawals of ruling requests, taxpayer inaction upon Counsel requests for further information, and Counsel decisions to decline to rule. This latter category includes both instances where it would be inappropriate to rule under stated policy, for example, where a requested ruling would be too factually based, and instances where broader guidance exists making a private letter ruling unnecessary. In both instances, user fees are refunded. Finally, some of the difference can be accounted for by the fact that a ruling may be requested in one fiscal year and the project closed in the subsequent fiscal year.

Q6: *What IRS information collections under Code section 6011(a) would not be "statutorily imposed" under the Paperwork Reduction Act (PRA) and what guidance has been issued to the field about imposing penalties on noncompliant taxpayers notwithstanding forms or regulations that do not comply with the PRA? (Additional Question)*

A: The IRS has not had to consider this issue with regard to section 6011(a). In order to determine whether 6011(a) is an "authorization" or "statutorily mandated," an opinion by the Chief Counsel would be required. The IRS considers this action unnecessary because, since the effective date of the PRA of 1980, all regulations and forms prescribed under section 6011(a) have been, and will continue to be, sent to the Office of Management and Budget for its review and will display the required control numbers and language. As a result, the IRS does not have to face whether the information collections authorized by section 6011(a) are "statutorily imposed" under the PRA or what guidance to issue to IRS Field offices about imposing penalties when information collections are not in compliance with the PRA.

Q7: *What is the IRS doing with faxes? (Page 86)*

A: Next filing season, the IRS will provide another choice for taxpayers and businesses who need to get tax forms and instructions quickly. This service will allow taxpayers to call from their fax machines and retrieve any of the dozens of the most requested federal tax forms and instructions. The service will be accessible 24 hours a day, 7 days a week.

The IRS will use high resolution, fax on demand technology, to make forms and instructions available in minutes, with one call. For people who need a few forms, they can call from their fax machine and get a list of tax products available and on the same call receive the items they selected from that list.

Q8: *What are the IRS's comments on alternatives to the Christensen Bill?*  
(Page 63)

- A: Any legislation changing the definition of employee should be easy for both the IRS and businesses to administer. While the IRS does not have specific legislative language, there are specific criteria that we believe must be met in order to achieve an administrable definition of employee. These are:
- The definition needs to replace the common law standard completely.
  - The definition of employee should apply for all Internal Revenue Code purposes.
  - The definition should be understandable for all -- the IRS, businesses, and workers.
  - The definition should be objective.
  - The definition needs to be easily verifiable by businesses, as well as the IRS and workers.
  - The definition, if possible, should not result in substantial reclassification of existing workers.

If a new legislative definition meets the above criteria, the legislation should also contain modifications to Section 530 of the Tax Reform Act of 1978, and it should contain provisions to enhance the IRS' compliance efforts in ensuring that income is properly and adequately reported.

Q9: *What is the administrative impact of the estate tax proposal regarding the exclusion of family owned business interests?* (Page 92)

- A: The family owned business exclusion compounds an existing area of noncompliance: the valuation of closely held business interests. Resolving these issues are costly and burdensome for both the taxpayer and the Secretary. In addition, the legislation creates a framework which will be nearly impossible to monitor and to track, provides many opportunities for noncompliance, and will be costly to administer. The legislation lacks clear definitions, includes wholesale incorporation of other sections by reference without relating its application in this instance, and creates a recapture provision which will be impossible to enforce.

#### **Valuation of Closely Held Business Interests**

The most critical area of noncompliance in transfer taxes is the valuation of the

closely held business interest. Excluding some portion of that business increases the incentive to improperly lower the closely held business interest value. Valuation principles become important not only for inclusion, but also for exclusion, and the chance to completely avoid tax.

The valuation of these entities is art, not science. As a result, experts decide value by applying the fictional test of a willing buyer and seller. After determining the value of the business as a whole, these experts decide the value of the decedent's interest. This often involves discounts to the prorata ownership share based upon marketability, minority ownership, and sometimes, the manner of ownership.

The compliance issue arises because the willing buyer and seller do not exist. As indicated by the purpose of the legislation, families want to keep their businesses in tact. They do not want to sell. An element of the formula is missing. Thus, the experts use theories and formulas supported by their experience to arrive at a value. Each side employs experts. They settle the issue, sometimes at the examination level, but more often in appeals or in court. The process uses valuable resources. It represents a significant commitment when tax is at stake. This provision requires the Secretary to expend those resources to determine when tax might be at stake.

Beyond resources, the system encourages noncompliance by rewarding taxpayers who take the most extreme positions. Those who take more moderate approaches, or who cannot afford the expensive experts, pay the full tax as prescribed. According to data provided by Examination, these discounts range from zero to 90% of the prorata value. The average discount is 42%. The allowable amount averages between 15 and 27%. The effect is that the maximum \$3.25 million exclusion provided by law grows. For example, a decedent owns an interest whose prorata share of the whole business is \$10 million. He determines the amount includable:

<b>Prorata Share of Family Business Value</b>	<b>\$10 Million</b>
Less:	
Marketability and/or Minority discounts (42%)	\$4.2 Million
Family Exclusion (\$1.5 plus one half amount between \$1.5 and \$5M)	\$3.25 Million
<b>TOTAL INCLUDABLE</b>	<b>\$2.55 Million</b>

The effect of the discount is to increase the \$3.25 million exclusion to \$5.6 million.

If the taxpayer had discounted the interest by 15%, the includable amount is \$5.25 million. Excluding part of the interest based upon those extreme positions increases the inequitable treatment of taxpayers.

**Impossible to monitor and to track, provides many opportunities for noncompliance, and will be costly to administer.**

The legislation excludes a part of the closely held business from the gross estate. It does not include any notice provisions. As a result, the Secretary cannot identify the excluded property. There may not even be a requirement to file a return where other property interests or transfers do not exceed the unified credit amount.

Beyond that, the legislation does not clearly say when it applies. Instead, it contemplates a convoluted computation based upon the value of the adjusted gross estate, gifts made during lifetime, the business nature, and family member activities.

The provision takes other Chapter 11 concepts and gives them new meaning. For example, to know if the estate qualifies the executor must know the value of the adjusted gross estate. Here, he must consider gifts to family members and annual exclusion gifts. Generally, adjusted gross estate does not include gifts. The transfer taxes ignore annual exclusion transfers. This is bound to create taxpayer confusion and noncompliance. Further, annual exclusion gifts may not be reflected in a gift tax return. The Secretary cannot verify this computation. The taxpayer will be the only who has the information necessary to determine whether the business meets the threshold test. We will have no means to monitor and track.

The provisions relating to the business nature are equally difficult to apply. Exclusions of interests in readily tradable stock, the requirement to exclude portions of a business attributable to cash and marketable securities and references to personal holding companies serve to muddy the water. The Secretary cannot determine whether the estate meets the test without considerable expenditure of resources.

The wholesale incorporation of entire sections of Section 2032A, without explanation of how they apply in this instance, makes it impossible for the Secretary to ascertain the intent of the provisions. Exclusion of a portion of a business interest is much different than the special valuation of real estate used in a business. Therefore, more precise language is needed to ascertain Congressional intent. Valuation of real estate is a more precise task than valuing a portion of business entity. With real estate, the fair market value is ascertainable through comparable sales. There is a market for real estate used in the business. Only the real estate is special use valued, and the statute provides specifics for determining that value. The family business exclusion does not provide valuation guidance. Instead, the value is based upon fictional and speculative valuation principles which attempt to determine fair market value. These

interests, however, rarely trade in the arms length, willing buyer/willing seller environment contemplated by Section 2031.

Further, the family owned business exclusion provision relies upon the concepts of special use valuation to define the required activities of the decedent and family members. It expands that concept to long term employees without explanation. Even if the analogy were more clear, regulations have not been promulgated for the special use provisions cited. The Secretary, and taxpayers, are without clear direction. We will both spend unnecessary resources to interpret the provisions.

Finally, the recapture provisions are unenforceable. They do not detail what kinds of disposition will trigger recapture. For example, what if the business interest is sold, but the corporate structure is maintained with the proceeds of the sale being the primary asset. What will alert the Secretary that a disposition has occurred? The reliance on liens is misplaced. Any liens attach to stock or partnership interests, not to real estate. In the same respect, the qualified trust provisions do not address questions of invasion, trust duration, and subsequent trust distribution. Absent clarification the interests of the government may not be adequately protected should a recapture occur.



COMMISSIONER

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

March 22, 1996

The Honorable Jan Meyers  
Chairman, Committee on Small Business  
House of Representatives  
Washington, DC 20515

Dear Madame Chairman:

This is in response to your letter of January 24, 1996, concerning the Internal Revenue Service's views on certain aspects of the Paperwork Reduction Act of 1995 (PRA).

Attached to this letter is a technical memorandum prepared by our Office of Chief Counsel that responds to the specific questions raised in your letter. Also attached is the latest complete inventory of all of IRS' "collections of information" within the meaning of the PRA.

I appreciate your continuing interest in the issue of regulatory burden on small business. As I said last October, the IRS is committed to reducing burden for all taxpayers, and I look forward to working with you on this issue in the future.

Sincerely,

A handwritten signature in black ink, appearing to read "Margaret Milner Richardson".

Margaret Milner Richardson

This memorandum responds to the questions raised in a letter to the Commissioner of Internal Revenue dated January 24, 1996, from Chairman Jan Meyers of the House Committee on Small Business.

#### BACKGROUND

Currently, the IRS has 553 control numbers that have been assigned by the Office of Management and Budget pursuant to the Paperwork Reduction Act ("PRA"). Each control number generally corresponds to several "collections of information" within the meaning of the PRA. Attached is an inventory of the IRS' collections of information as of February 29, 1996.

#### QUESTIONS AND ANSWERS

- Q1. What forms, reports, recordkeeping requirements, or other kinds of "collections of information" imposed on persons does the IRS not consider within the scope of the language of section 6011(a) of the Internal Revenue Code?
- A1. The IRS submits all forms and other collections of information subject to the PRA to OMB for approval. Accordingly, the IRS has never needed to specifically identify which of the collections of information sponsored by the IRS are not within the scope of section 6011(a).
- Q2. Given the present IRS inventory of "collections of information" cleared by the Director of the Office of Management and Budget and assigned control numbers, would you please list those collections and their respective control numbers which the IRS considers "imposed on persons by statute" and those which it does not.
- A2. As noted in the answer to Question 1, because the IRS submits all forms and other collections of information subject to the PRA to OMB for approval, the IRS has not attempted to specifically identify which of the collections of information sponsored by the IRS are imposed on persons by statute or not so imposed.
- Q3. Are there any "collections of information" not contained in the present inventory which the IRS considers "imposed on persons by statute?"
- A3. As noted above, the IRS submits to OMB all collections of information required by the PRA, regardless of whether the collections of information are imposed on persons by statute.

March 22, 1996

- Q4. Does the IRS consider collections of information "imposed on persons by statute" subject to the scope of the public protection section (section 3512) of the Paperwork Reduction Act or does the IRS consider those collections exempt from the protection provided by the section?
- A4. Although tax protesters regularly assert that the IRS has not complied with the PRA, we are not aware of any case in which a court has found that the IRS violated the PRA. We note that the courts have held that an information collection is enforceable, notwithstanding an Agency's noncompliance with the PRA, if the information collection is statutorily imposed on the public. See e.g., U.S. v. Neff, 954 F.2d 698 (11th Cir. 1992), U.S. v. Hicks, 947 F.2d 1956 (9th Cir. 1991), and U.S. v. Wunder, 919 F.2d 34 (6th Cir. 1990).
- Q5. The Paperwork Reduction Act requires the IRS to estimate the burdens associated with its regulatory paperwork. What is the present IRS estimate of the burden hours imposed on the public by its information needs? Would you provide an estimate of what proportion of the burden hour total is "imposed on persons by statute?"
- A5. As shown on the attached inventory, as of February 29, 1996, the total burden imposed by all IRS collections of information subject to the PRA is estimated to be 5.29 billion hours. For the reasons set forth above, the IRS has not attempted to determine which of these collections of information are imposed on persons by statute.

March 22, 1996







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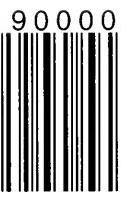
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